What Prolonged the Great Depression?

BY MATTHEW CONNER

"Capital Taxation During the U.S. Great Depression." Ellen R. McGrattan, Federal Reserve Bank of Minneapolis Working Paper 670, April 2009.

While most economists would argue that the main cause of the Great Depression was unwise monetary policies, such policies alone cannot adequately explain the severity and duration of the crisis. In this paper Ellen McGrattan of the Minneapolis Fed seeks to prove that some fiscal policies during the period had more than a small impact. One key insight of the paper is that prior studies on this topic have assumed that the only sort of capital taxed during this period was profit. Yet the big change in policy was actually a substantial increase in the taxation of dividends in the Revenue Act of 1932.

As McGrattan suggests, even the anticipation of dividend taxation — a proposal publicly suggested by President Herbert Hoover as early as 1930 — could have had an effect on investment in that period. In addition, the studies that suggest tax increases had little or no effect note that few people actually paid income taxes during this period. McGrattan notes that while this is true, the taxpayers who did pay those taxes earned almost all of their income through dividends.

Adding dividend taxation to the standard growth model on which the majority of research on this topic is based, McGrattan discovers that a large fraction of the observed declines in real GDP between 1929 and 1933 is explained by her tax-inclusive model. Additionally, the decline in production hours per capita during this period also can be explained by her model.

"The Olympic Effect." Andrew K. Rose and Mark M. Spiegel, Federal Reserve Bank of San Francisco Working Paper 2009-06, March 2009.

The right to host a mega-event such as the Olympics or the World Cup is seen as an honor to the nation chosen, but economists are skeptical about the economic benefits. In practice, these events usually end up imposing large costs on their hosts that are not often fully recovered through revenue during the event or from the structures that are left over afterward.

While it is commonly asserted that hosting the Olympics will promote a nation's exports, economists Andrew Rose of the University of California at Berkeley and Mark Spiegel of the San Francisco Fed examine the empirical evidence. They find a large positive effect of the Summer Olympics on both exports and overall trade. (The Winter Olympics are not studied due to the fact that fewer countries are able to host that event.) The authors also found a strong positive effect on trade from other mega-events such as the World Cup. The research shows that Olympic host countries have seen up to a 30 percent increase in exports. Yet the authors also find an almost equal increase in trade in the nations that vied for the right to host the event but were not chosen. This implies that the effect on trade comes not from actually hosting the games but from bidding for them in the first place.

The authors speculate that this increase results from the signal that bidding to host the event sends to the world. This "signaling strategy" conveys the country's interest in trade liberalization. This idea is illustrated by the fact that just two months after being awarded the right to host the 2008 Summer Games in July 2001, China successfully concluded negations with the WTO, thus formalizing its commitment to trade liberalization.

"Subprime Mortgage Pricing: The Impact of Race, Ethnicity, and Gender on the Cost of Borrowing." Andrew Haughwout, Christopher Mayer, and Joseph Tracy, Federal Reserve Bank of New York Staff Report 368, April 2009.

Some have argued that during the peak period for subprime lending (2004 to 2006) minority borrowers were saddled with higher interest rates than nonminority borrowers. The authors of this study test that claim using a new sample that merges data on more than 75,000 adjustable rate mortgages with information on the race, ethnicity, and gender of the borrowers. This dataset allows them to examine the differences in mortgage lending while controlling for both the risk profile of the mortgage and the characteristics of the neighborhood in which the property was located.

In contrast to some previous findings, their results show that there is no evidence of adverse pricing for most minority demographics. If anything, many minority borrowers actually received slightly lower rates. Black and Hispanic borrowers paid a slightly lower initial mortgage rate than other borrowers, although Asian borrowers paid a slightly higher rate. No appreciable differences were found in lending terms based on gender. Finally, the adjustable rates on the mortgages did not "reset" at higher levels for minority borrowers relative to nonminority borrowers when one controls for risk and location. The authors conclude that these results suggest the possibility that subprime lending was a credit innovation that did serve as a positive credit supply shock in locations with more minority residents. **RF**