Chapter 20

Strategic and Innovative Actions of the Government During the Financial Crisis:

A Historical Analysis Between 1929 and 2008

Seçil Şenel
Istanbul Medipol University, Turkey

ABSTRACT

Financial crises cause significant economic and social problems for the countries. Many companies stop their operations and a lot of people lose their jobs. Especially after the globalization, there is an increase in the number of financial crises. Because of this aspect, governments try to implement necessary actions to prevent the crisis. In this scope, government intervention to the market during the crisis period is a much-debated concept. The aim of this chapter is to identify the success of government intervention in the market in crisis period. For this purpose, three different financial crises are analyzed, which are 1929 Economic Depression, 2001 Turkish Economic Crisis, and 2008 Global Mortgage Crisis. As a result, it is identified that when government intervene into the market in crisis period, the countries can much easily overcome the crisis. Therefore, it is recommended that strategic and innovative actions should be taken by the government in case of economic crisis, such as increasing liquidity level and implementing new regulations.

INTRODUCTION

Financial crises had significant negative influences on the countries in many different aspects. In financial crisis periods, lots of different companies stop their operations (Dinçer & Owusu, 2015; Lemmon & Lins, 2003). It means that the investments decrease in the countries. Additionally, because of closing companies, a lot of people lose their jobs. In this circumstance, decreasing investment lowers economic development. Moreover, people losing their jobs have an increasing effect on unemployment. It shows

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that financial crises have negative effects on both economic and social ways (Reinhart & Rogoff, 2008; Campello, Graham, & Harvey, 2010).

Globalization process affected the international trade in the world. Due to the globalization, companies got a chance to operate their activities in many different countries in the world. This situation has a lot of advantages for the countries, such as higher quality services (Dinçer, Yuksel, & Adalı, 2018a; Tunay & Yüksel, 2017). On the other hand, it can be said that globalization causes some disadvantages. As an example, because companies entered many different countries, the level of the competition increased which has a negative effect on the financial performance of the companies. Another important negative influence of the globalization is the currency crisis which refers to the volatility in the currency exchange rates (Mougani, 2012; Dinçer, Hacıoğlu, & Yüksel, 2018b). It can also cause negative effects for the countries that have foreign debts.

While combining these two different paragraphs, it can be understood that there is a positive correlation between the globalization and the financial crises (Kim & Kim, 2003; Prasad, Rogoff, Wei, & Kose, 2005; Eichengreen & Bordo, 2003). There were lots of different financial crises in the history, such as 1929 Economic Depression and 1973 oil crisis. However, it can be seen that the number of the financial crises increases dramatically in the last decades (Oktar & Yüksel, 2015; Colander, Goldberg, Haas, Juselius, Kirman, Lux, & Sloth, 2009). This situation shows that the negative aspects of the globalization had such an enormous influence on the financial performance of the countries that it caused important financial crises.

Since financial crises affected countries significantly, some actions should be taken to minimize the negative effects of these crises. In the literature, there is not a consensus about the role of the governments in financial crises periods. Some researchers think that governments should not intervene the market in these periods (Dowd & Hutchinson, 2010; Crotty, 2009). They think that market can solve this problem automatically after a time. Nevertheless, some other researchers underlined the importance of government intervention in the financial crises. It is thought that owing to the government intervention, the problems can be solved much easily (Lima, Grasselli, Wang, & Wu, 2014; Sharma, 2004; Ding, Wu, & Chang, 2013).

1929 Economic Depression is one of the most popular financial crises in the world. It started in United States and had a significant effect on many different regions of the world. This crisis caused also some social problems because a lot of people became unemployed in this process (Karakaya, 2012; Fuders, Mondaca, & Azungah Haruna, 2013). The important point in the literature about this crisis is that government did not intervene the market in this crisis period. Many researchers think that it caused to see the negative effects of this crisis for a long time. It took lots of years to reinvigorate the economy.

On the other side, 2008 global mortgage crisis is another important example with respect to the financial crises. This crisis caused many different countries in the world (Yüksel, Mukhtarov, Mammadov, & Özsarı, 2018). Lots of big companies, such as Lehman Brothers went bankrupt in this crisis period (Nobi, Maeng, Ha, & Lee, 2014). Similar to 1929 Economic Depression, macroeconomic conditions of the companies were affected importantly after this crisis. However, the main difference between these two different crises is that governments had an active role in 2008 global mortgage crisis. In this context, governments decreased interest rates with the aim of increasing liquidity level in the market and made financial helps to some companies to prevent bankruptcy.

The aim of this study is to assess the role of the governments during financial crises in a historical manner. For this purpose, 3 different financial crises are analyzed which are 1929 Economic Depression, 2001 Turkish Economic Crisis and 2008 Global Mortgage Crisis. The role of the governments in these