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The stock market crash of 2008 caused the Great Recession: Theory and evidence

Roger E.A. Farmer

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Abstract

This paper argues that the stock market crash of 2008, triggered by a collapse in house prices, caused the Great Recession. The paper has three parts. First, it provides evidence of a high correlation between the value of the stock market and the unemployment rate in U.S. data since 1929. Second, it compares a new model of the economy developed in recent papers and books by Farmer, with a classical model and with a textbook Keynesian approach. Third, it provides evidence that fiscal stimulus will not permanently restore full employment. In Farmer's model, as in the Keynesian model, employment is demand determined. But aggregate demand depends on wealth, not on income.

Keywords

Unemployment; Keynesian economics; The stock market

JEL classification

E20; E30; E32; G01

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