

THE CRISIS ABC FROM A SCHOLASTIC POINT OF VIEW

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ABSTRACT

This paper particularly analyzes the economic crisis in a temporal way facing its conventional and modern sides, on the way to identify the best solution.

Each period of time is a transition from traditional to modern, providing similar incomplete solutions. It's no secret that after the economic recovery and almost three decades of national growth in the global economy periods of crisis occur repeatedly. In such cases the crisis remains a hot topic for scientist, business-owners, and media.

KEYWORDS: *crises, solutions, sound development, new stage of market development*

JEL CLASSIFICATION: *E1, E10, E2, E13, E20, E24, E25, E37*

1. INTRODUCTION

For sometime theory of the firm has become a very active area of research not only by economists but also by physicists. Numerous critics were addressed over the years with regard at its internal consistency and empirical relevance. It was the uni-dimensional approach and description of the motives of firms that occupied the main place of discussions. Nowadays given the results of the crisis in the world economy, the current against it got a stronger voice generating an increasing number of publications to reconsider it. Errors have been outlined, emptiness of a longtime valid theory has been spread alaround, focused on the idea of (non)equating marginal revenue and marginal cost, on profit maximisation, competition, development and behaviour under crisis.

This paper is trying to emphasise a historic an complex approach of these theories, managing towards new understandings inside economy and society. The science of economics and society are as complex and active as the world economy and managed towards stating that booming times feed the wispy signs of future crises. The Japanese economic meltdown, the Long Term Capital Management crisis, the Russian crisis, The Great Depression, the Mexican or Asian crisis are good examples in this respect. At present, we understand better the cloudy signs of the 2007 in the United States of America of which effects dispersed widely all over the continent. Certainly their causes and future effects were differently engaged the scientists' polemics that were, frequently exaggerated. The debates generated different opinions and the split of the economists in different categories according to their conventional or modern approaches in promoting appropriate solutions. That is why in presenting the definitions and solutions of the crisis we will refer to different opinions and to different periods of time.

2. THE DEFINITIONS OF CRISIS OVER THE YEARS

Since Adam Smith to John Maynard Keynes (1936) , continuing with the followers of the Austrian school, and concluding with current opinions of the economists, each has his part of truth in how they understands and presents the economy of crisis. The economy of crisis studies the ways and

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reasons for which the markets fail. The same economic mainstream, on the other side demonstrates the ways and why markets work well or not. This concern is a traditional one, with origin in the schottische economist Adam Smith (2011) - "The Health of Nations". He is the creator of the famous metaphor "the invisible hand" that express how the divergent interests of the economic actors are apparently adjust themselves, moving always towards kind of a magical balance. Smith discloses nothing about the multiple vulnerabilities in the markets, explaining not why they fail but instead why they have success. Adam Smith's theory is resumed by many other economists like David Ricardo, Jean Baptiste Say, Leon Walras, Alfred Marshall.

In theory, the Great Depression should have to end this error, but the faculties of finance and economy brought back to life with renewed force the old misleading error. Moreover, a professor - Eugene Fama (1995) from the University of Chicago, built complicated mathematical models designed to demonstrate that markets are entirely rational and efficient. This idea bear to the theory of "random walk" that says - when you have the possibility to choose the actions in which you want to invest, there is no point to strive to be better than your competitors. According to this logic, the best thing to be followed is to take some random action, and stick to your choice, not taking into account the market movements.

Those economists embracing the theory in the postwar years admitted that markets are more or less effective depending on certain variables - and called it the efficient market hypothesis. However the first economist who has paid more attention to crisis was John Stuart Mill (1909). In his book, the principles of Political Economy, he speaks about the speculative balloons that appear when "an accident" - an external shock - a new market for example - "put in motion the speculation." Alone, only the balloon does not succeed to create the crisis. It was basically helped by credit and debt - which in turn played essential roles in the game of speculation. As the speculative bubble grows, simultaneously takes place the expansion of credit. The prosperity ends when the unexpected failure of some companies causes a general distrust in the market, making almost impossible to obtain credit otherwise than in onerous conditions.

Marx and Engels (2002) produced a somber version of the crisis genesis, considering it as part of capitalism, an imminent and inevitable sign of future collapse. "Commercial crises, he said, by their periodical return tests each time more ominous, the existence of the entire bourgeois society." "How the bourgeoisie exceeds these crises?" wondered Marx. On the one hand, by destroying by force the mass of productive forces, on the other by the conquest of new markets and exploiting the old ones more thoroughly. "But these solutions are not doing something else but delay the last day of collapse, paving the way for more extensive and more destructive crises, and lowering the means to prevent their occurrence."

Marx was the first seeing the capitalism as inherently instable and prone to crisis - the embodied chaos that will inevitably plunge into the abyss, taking after him the economy too.

It was John Maynard Keynes who followed Marx studies on crisis, from a completely different point of view. During the great depression and after he developed "the paradox of thrift" showing that, as the demand falls, more and more entrepreneurs are reluctant to invest, and this can only result in wage reductions and layoffs. Ordinary consumers will consume less, and will save more. For Keynes, the solution was simple; the government will have to replace missing players and will create demand. In addition to this, the state should use his authority to levy taxes improving in this way the difficult economic situation.

There is not a general agreement with regard at his postulate. Friedman and Schwartz, for example, have opposed to state intervention, primarily because of the government spending. On the same side with them were the many followers of the Austrian school and their successors, who had a lack of confidence in the government intervention. Another aspect issued inside the Austrian approach focused on individual entrepreneurs, - as the economic unit analyze.

Schumpeter (2006) developed a convincing theory about entrepreneurship, synthesizing to a very simple level: the creative destruction. In Schumpeter's view, the capitalism consists in values of

innovation in prosperous periods followed by screening brutal market actors in times of depression. This screening of force should be avoided or minimized because it is an act of adjustment - good and painful, whose survivors will create a new economic order.

Today the vision on the crisis has changed and new ideas or interpretations rose. The current literature outlines divergent explanations; the heterodox approach focuses on the need of a more comprehensive and complex approach to the issue linked to the other sides of society and economy, issuing dramatic changes in asset values in response to fundamental changes in the economy. Contrary to those models developed on the currency crises (Krugman, 1995) explaining the collapse by the deterioration of public finances, there are others (Nouriel Roubini) pointing out the signs of the end of the current system: "As American power is eroded in the years that come, crises might become more frequent and virulent in the absence of a super powerful and capable to cooperate with other emerging forces to bring the same kind of global economic stability. (Roubini and Mihm, 2010)

According to Stiglitz (2010), the recent economic crisis promotes some solutions for leaving the recession: the government intervention and regulation in several areas. It reflects, unilaterally, the idea that without fundamental changes in the economic policy and no regulations on the U.S. positions in the world - the political and the economic scene is on the verge of damage worldwide. Paul Krugman put a parallel into the causes that produced the Great Depression, with the ones that produced the current crisis. In his book "The Return of Depression Economics", Krugman makes a study of the economic crises that swept Asia and Latin America. These crises were a warning to everyone: like diseases that have become resistant to antibiotics, the economic diseases that caused the Great Depression were actually a revival of the economy. After this event, occurred the famous growth on Wall Street, and then the dealers have made big profits. In this way the international crises of 1990 have easily gone from the memory of both consumers and entrepreneurs. In the case of the current economic crisis, the start was given by the United States when the housing bubble burst. He describes the way deregulation were those that led to the production of the greatest economic crisis after 1930s.

All this debate about the past crises may seem at first look a simple theoretical presentation. The Austrian economists argue with historical arguments that the policy of reaction to the recent crisis will eventually drive us to the worst evil. Not letting banks, decrepit corporations and households who excessively indebted - to perish in these mode allowing only the strong to survive and prosper, governments around the world have gave birth to an economy of undead. In this case the private losses are socialized. They become the burden of the whole society and by default of the country government, as the budget deficits lead to unsustainable increases of the public debt. Over time, the assumption of such liabilities may endanger the finances of a state, reducing the long term growth. In extreme cases the government will be obliged not to pay its obligations, or alternatively to bring into service the money printing press in order to redeem the debt - tactic which can trigger flare-ups inflationist hazardous intense, an anemic economic growth, like the stagflation that tortured the United States in 1970. In such critical situations, we must have learned from the Austrian economists who think that must be allowed to take place the inevitable liquidation as soon as possible. Instead, when it comes to medium term the Austrian school is the one which teaches that a financial crisis cannot be solved in the medium and long term than if everyone from the economy from the big corporations to the population reduces their debt level. This was the lesson that most countries did not listen in the current economic crisis.

The study of the economic crisis cannot be summarizes only on economic theory. Studying the past is important not because history would repeat again and again in some simplistic and cyclical way, but because of the raw material that the history has - material that can give life to the new theories and economic models. The paradox is precisely this: a belief in such new models has helped to create the current crisis conditions, blinding the operators of investment and market actors, in front of the risks that have accumulated over the years. A modern description of the

current crisis would be as follows: a speculative bubble in the housing market from the United States came out of control. Population took mortgages that they could not allow, and eventually could not pay their rates. Since the mortgages had been secured previously, the evil did not stop here, and the global financial system was messed up. The government also has its share of blame, the most important one being the monetary policy applied by Alan Greenspan.

As the purpose of this paper has to do more with those issues colligating schematic phenomena to complex solutions, we summarize here some of them, entitle to be considered:

- a. Regularity in risk-taking (when economic conditions are favorable appear innovations - technical, technological, financial. In the very next moment the investors tend to assume high risks. Inversely, when conditions are unfavorable for economic development, the investors are excessively cautious). Fed chairman Ben Bernanke has called this mechanism "the financial accelerator";
- b. Both monetary policy and the conduct of banking institutions and people led to an excessive debt, and to an increase exclusively based on consumption, which proved eventually to be unhealthy;
- c. The value of the assets was far exceeded, fact that led to the creation of "bubbles";
- d. Disorders from the banking system, which led the bank panic:
 - the contagious demand of withdrawal of the deposits;
 - difficulties of refinancing on the interbank market;
 - deterioration of bank debt due to payment difficulties of debtor followed by bankruptcy.

3. CRISIS TYPOLOGY AND CLASSIFICATION

The typology of crises is important in studying the mechanisms of triggering the crisis, because this helps us to identify the steps that led to the production of crisis, and the appropriate strategies of manage them.

There are many models that present the stages of crises. Below I will present the two prominent ones.

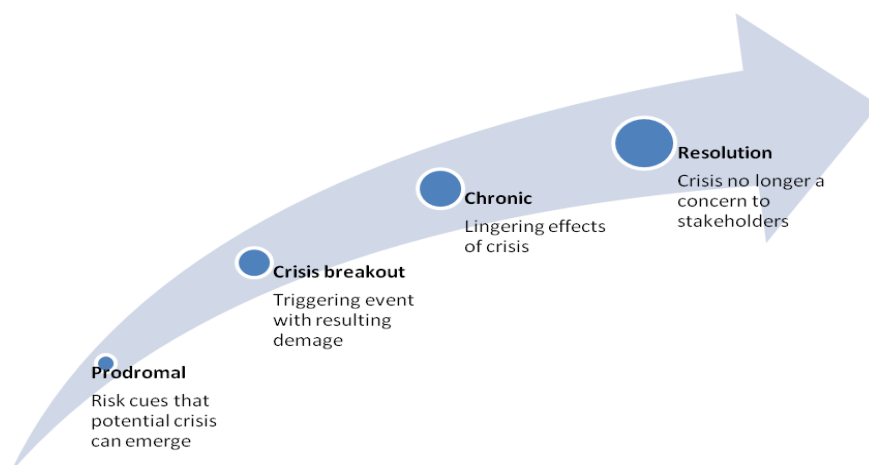


Figure 1.Fink's Crisis Lifecycle

Source: authors adaption

The stages of crises enable planners to monitor risks, progress, target stakeholders, and take strategic action appropriate to the stage.

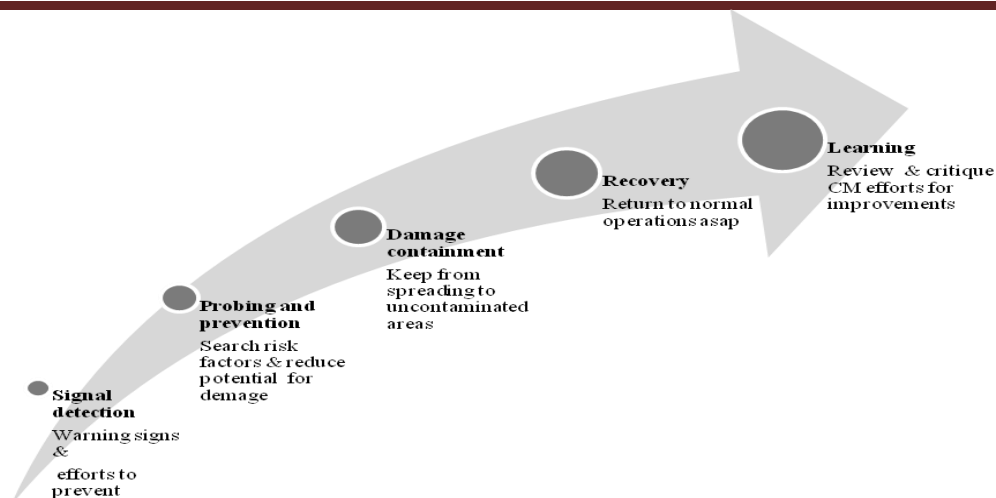


Figure 2. Mitroff's five stages of Crisis Management
 Source: authors adaption

The crises can be classified according to the causes that produced them, the magnitude they have, the level to which they acts and their consequences on population and economic environment. Classifying is the first step that we have to do to keep them under control, since they can be name and analyzed. Classifying crises is like shooting a moving target, because the events of the future are likely to be very different from today, and today's unforeseen events, in hindsight, may no longer be seen as a crisis (Gundel, 2005).

History is the one that caused us to divide crisis first of all according to their principal cause. Thus we meet man-made crisis often called "Acts of Men" and natural, often called "Acts of God". In addition to these there are natural and social, normal and abnormal crises, avoidable and unavoidable or normal accidents. But rankings do not stop here.

In a system of coordinate axes S. Gundel put predictability on the vertical and degree of influence on horizontal, obtaining in this way a matrix of crisis, as shown in figure 3.

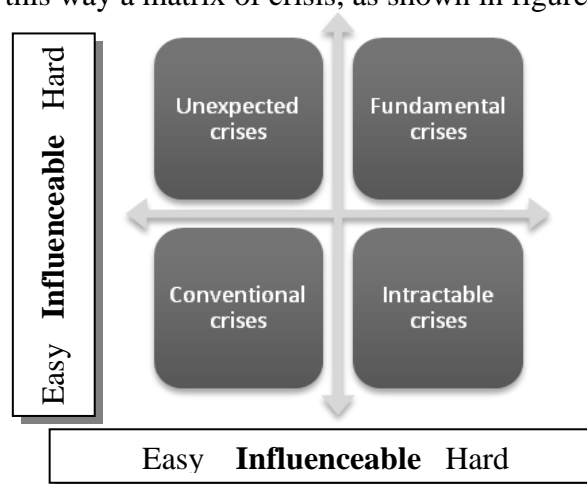


Figure 3. Gundel crisis matrix
 Source: adapted from Gundel (2010)

S. Gundel wants to discover through this if you can or cannot predict a crisis, or if a crisis can or cannot be influenced. "Conventional crises are located in the first quadrant, they are predictable and influenceable. Typical examples are technological events like Bhopal disaster and the Estonia

ferry sinking. Unexpected crises are found in the second quadrant, they are hard to predict, but can be influenced when they occur. Typical examples of these ones are the Kaprun tunnel blaze and the Mann Gulch fire disaster. Intractable crises can be anticipated but interference is practically impossible, making responding difficult and preparing hard. Typical examples for these ones are the Heysel Stadium disaster and Chernobyl nuclear power plant accident. Fundamental crises are located in the fourth quadrant and represent the most dangerous class of crises, since they can be neither predicted nor influenced" (Gundel, 2005). As a typical example S. Gundel cites the terrorist attack from September 11.

The modernity of crisis brings forward the current economic crisis. Those that have given birth to such an unprecedented crisis are the speculative bubbles, the technological innovation and the progress - in fact the terms that define the new economy. Technological innovation found itself in the financial system, presenting improvements of the old system of making loans.

Thanks procedures called "securitization" non-active liquids - such as mortgage loans - could be converted into liquid assets traded on the open market. These new tools have named the mortgage-backed securities, or short: mortgage securities. New design at first glance seems simple, but on a more detailed analysis can be easily see that bad loans are not reviewed by anyone, but instead are passed from hand to hand like a hot potato (Purnanandam, 2009). Thus "lying loans" have become increasingly common: the applicants invest their nonexistent income without bringing any written confirmation of their salary. Most outrageous of all of these ones are those named "NINJA" after the acronym "No Income, No Job or Assets" (Kothari, 2006). Just as concluded a risk management manual in 2011: "Sometimes it seems that almost anything can be turned in a paper with value." It is no exaggeration: when the crisis broke out, had been securitized aircraft rental contracts, penalties for not paying tax on property, income from exploitation radio relay towers, loans for buying boats, state and local revenues, and even copyrights of some rock bands (Roubini and Mihm, 2010).

The speculative bubble of real estate would not have reached his true size, if it had not been helped by the state policies as a result of the massive deregulation and government inability to remain ahead with the financial innovation. All these factors - financial innovation, corporate governance failures, accessible money policy, state failures and the parallel bank system contributed to the onset of the current crises.

4. CONCLUSIONS

The recent crisis has only produced very little from its creative destruction that Schumpeter consider essential for the long term health of capitalism. Preventing these necessary adjustments through tax cuts and incentives does make only to postpone a final inevitable reckoning. The moment when it is appropriate to put the issue of moral hazard and other vulnerabilities in the financial system comes after the immediate crisis has passed. It's a shame to waste the opportunity of a financial crisis because it offers the possibility of a real and lasting reform in the global financial system. If the Great Depression removed the contradictions embodied by Hoover and replaced them with the ones of Keynes, the Great Recession will bring in its wake a new way to understand, and above all else to prevent the crises.

The crisis has revealed several realities. First of all that banks were in need to have better quality and greater quantity of capital. Then, "reserve - capital buffer" which been formed and a number of banks was not large enough to provide shelter for the monumental shock that housing market collapse and credit crunch have produced. Finally, bankers have figured out what really means the quality of capital - as it is defined with notions of rank first and second. The financial crises have a habit of making radical reforms seem perfectly reasonable. Considerate a whole, these reforms have created the greatest intervention in the financial system. Throughout the crisis, its effects have been countered with three kinds of weapons: traditional, conventional and modern. The

traditional one was to provide liquidity for the financial institutions. Less conventional was the creation of special facilities through which the state has made acquisitions to current liabilities of certain types - e.g. bills of exchange. The most radical of all programs was considered the FEDs commitment to intervene in the markets for long-term debt.

Thus, examples of successful innovation proved themselves as limited sources of market power, a sort of development by internal erosion, a high creative destruction trying to explain some of the dynamics economic changes seen on the market stage as a transition from a competitive to a monopolistic market, and back again. On a long run, at a general level, the creative destruction is definitely painful. The price is equally paid by individuals, entities and society; only in different temporal moments.

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