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SOCIAL ECONOMY AS A POSSIBLE SOLUTION FOR THE CURRENT WORLD ECONOMIC CRISIS

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***Abstract**: In this paper, the authors aim at realizing a comparative analysis between the Great Economic Depression of the period 1929-1933 and the global economic crisis beginning in 2008. Another objective of this paper is to highlight the causality of economic crises and the way of responding to this economic scourge that affects most countries in the capitalist world. Special attention is given to the analysis of the conception of John Maynard Keynes, the great British economist who dedicated a specialt treaty to the analysis of the big economic depression. The last part of the paper is focused on solutions for the current economic crisis and especially on social economy as a possible response to these economic difficulties.*

***Keywords**: Great Depression; Keynes; Krugman; Derivative; Social Economy*

1. Introduction

From 2008 up to the present, we have been witnessing an economic phenomenon which has shaken capitalism and which has serious economic, political and social consequences. First, panic on financial markets, media hysteria, rising unemployment, loss of homes by millions of people, chain bankruptcies, anti-Wall Street demonstrations in the United States, anti-government street protests and anti EU street protests in many European countries, a debt crisis of some countries in Southern Europe and Central Eastern Europe...We wonder how such consequences were possible. How can we stop this crisis? When will we overcome it? Is this crisis a sign of the decline of capitalism? Will it prove Marx's prophecy? We shall try to answer all these questions, which is not an easy undertaking.

First of all, we must notice an interesting aspect. As Robert Heilbroner stated, Karl Marx sentenced to death capitalism in 1848, the publication year of the famous pamphlet *The Manifesto of the Communist Party*. The capitalist system was declared as suffering from an incurable disease and although the fateful date was not announced, it

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was assumed that the agony was close enough for direct relatives - Communists - to avidly wait for the last breath that was to announce their powerful legacy. The vigil had begun even before the appearance in 1867 of *Capital* and with each spurt of speculative fever or with each industrial depression, the presumptive heirs rushed to the bedside of the dying, telling each other that the final revolution would occur soon...But the system did not die (Heilbroner, 2005: 195). Probably, if we keep the thread of Heilbroner's idea, the system would not die this time either. But this crisis is likely to lead to multiple changes in the capitalist system and in large corporations. We can ask ourselves, is contemporary capitalism the best of all possible worlds? Probably not, but it's equally likely that the system waits for a new Keynes to save it from perishing once again.

In order to understand this economic phenomenon, we must return to the past, to the crisis of overproduction from 1929-1933, because, according to some economists, the two major crises have a number of common elements.

Before the Great Depression of the interwar period, there were visible signs of prosperity everywhere and especially in the United States. Towards the end of the 1920s, America had found jobs for 45 million of its citizens, to whom it paid about 77 billion dollars in wages, rents, profits and interest, a stream of income that the world had never before seen. With God's help, Herbert Hoover, President of the United States during the Great Depression, was saying with sincere conviction, poverty will soon be banished from the country. In support of his prophecy, there was the undeniable fact that the average American family lived better, ate better, dressed better and enjoyed the pleasures of life more than any average family until then in the history of the world. John Raskob, chairman of the U.S. Democratic Party, noted that everyone has the duty to be rich... if an ordinary man saves $15 a week and invests in good common shares, after twenty years he will have at least $80,000 and an investment income of about $400 per month[1]. As, in the Great Stock market, the values had registered for half a generation almost uninterrupted growth, no one thought of what would follow. Hairdresser, banker or businessman, everyone was taking part in the game and each person was a winner. Many ordinary people had taken out mortgages to participate in the great game stock. The only question that was worrying them was how they had not thought of this before...

What followed, after this economic euphoria, surpassed even the most pessimistic imagination. In late October, 1929, the stock market crashed. Desperate and exhausted, stock agents were crying and tearing their shirt collars, watching stunned as fortunes melted like cotton candy... In two crazy months, the market lost all the ground gained in two years. Values totaling 40 billion dollars disappeared. After three years, the 21,000 dollars of theoretical wealth of the investor had fallen by 80%. Initial savings of $7,000 were barely worth $4,000. The visions of John Raskob and Herbert Hoover proved to be simple hallucinations... macabre jokes that were circulating and then speak for themselves. It was said that in addition to every action of Goldman Sachs, you received a gun as a supplement, and when you went to the hotel to rent a room at the reception, you were asked: is it for sleeping or for throwing yourself out the window… (Heilbroner, 2005: 286)

The depressing aspect of the Great Depression was that it seemed endless, with no return, no hope... In 1933, the American nation was slack. The country's income decreased to 39 billion dollars. More than half of the property existing four years before was annihilated. Average living standards went back to where they had been twenty years before. In American cities, there were 14 million unemployed people. It seemed that, in America, hope was crushed forever.

2. The General Theory of John Maynard Keynes

What happened next? First, the unraveling of the mysteries of the Great Depression came from an economist who was neither left oriented nor did he have proletarian sympathies nor was he an angry guy, as Robert Heilbroner describes the famous John Maynard Keynes. He was rather a traditionalist fellow, almost a dilettante, a calm man, a person with talent in many areas: mathematics, business, art, diplomacy. A man whose correctness does not prevent him from possessing knowledge related to other European politicians, including their mistresses or their financial neuroses and prejudices (Heilbroner, 2005: 290). Although sympathetic to the ideals promoted by the Russian Revolution, Keynes was not less critical of totalitarianism and especially of the sometimes violent radical transformation methods, used by the partisans of this system. He deeply abhorred the systems promoted by Hitler and Mussolini. The rise of Nazism may be related to worsening economic difficulties that represented one of the consequences of the nature of behavior that Keynes condemned in the paper that made him internationally known to the public, the paper about the economic consequences of peace. On the other hand, Keynes expressed hostility towards the socialist revolution that had begun in Russia, a fact that made Lenin characterize him as a "staunch opponent of Bolshevism, which he, as an English philistine, imagines under a monstrous, cruel, savage aspect "(Keynes, 1970: 9).

In the interwar period, the world economy was facing the acute and chronic problem of unemployment. All of the measures taken to reduce it were useless. Unemployment couldn't be reduced; it remained at high levels or even increased despite desperate efforts to create additional jobs. The share of the working population was on average 10% unemployed, and in the overproduction crisis of 1929-1933, was even over 25% unemployed (Popescu, 2002: 894). After evaluation of the International Labour Office of the 17 countries that kept record of unemployment, the number of unemployed exceeded the figure of 25 million during the crisis. But not only were they missing data on unemployment, but almost any legal provisions meant to help the jobless. Keynes's paper *The General Theory of Employment, Interest and Money* published at the end of 1934 is a direct reflection of the great crises of overproduction. Throughout the paper, Keynes makes considerations clearly inspired by the magnitude and duration of this crisis, by the desire to avoid a repetition of such upheaval and risk posed to social stability and by the ability to function within a perspective of the capitalist economic system. "Social dangers" is an expression that is repeated several times in the text of Keynes. The main phenomenon that determines its use is unemployment which, as previously mentioned, reached massive proportions. The miserable situation and mood of those directly affected by the economic crisis explain Keynes' fears. He emphasizes the need to

remedy this situation, to use the labor force, a conception that is reflected in the *General Theory*, starting with the title and ending with the notes of the final chapters.

The opinion that unemployment, more than the other manifestations of the crisis, has directly influenced the ideas of *General Theory* is reinforced by other elements. In England, the unemployment rate was, during the third decade preceding the Great Depression, one of the highest. Joan Robinson showed that the percentage of the unemployed in the economically active population was over 10% for a long time. In 1929, the absolute number of unemployed in Britain (1 million people) was surpassed only by the United States (14 million) and Germany (1.9 million), and their share in the total of the economically active population was surpassed only by the German share.

Keynes' concern for the issue of unemployment begins with his work on the consequences of the peace and continues with *General Theory*. Keynes believed that the difficult economic situation could jeopardize the very existence of capitalism. Socialist revolutions, the emergence of governments that proclaim the abolition of capitalist ownership, undoubtedly have a role among the primary sources for the future *General Theory*.

The economic theory prior to Keynes' one and the solutions offered by the former to unemployment proved ineffective for solving the complicated problems of the interwar period. With few exceptions, classical and neoclassical thinkers believed that free market mechanisms are capable of automatically and continuously maintaining both equality between savings (S) and investment (I) and complete employment of labor force. In any moment of evolution, society's resources, including those related to labor are fully used, and with maximum efficiency.

The general theory developed by Keynes is first and foremost a theory of an economic overproduction crisis. What he was interested in was to discover the factors and mechanisms that caused this type of crisis. He therefore postulated and focused on the existence of the population's tendency toward over-saving. As they saved too much, Keynes said, people determine the decreased global demand for commodities; because of a decreased global demand, there appears the surplus production (overproduction), but more seriously, businesses' revenue decreases, which, being nothing else but the very source of income, leads to lower income, which in turn leads to a further decrease in the general demand, etc. Hence, bankruptcy, unemployment, and indefinite extension of the crisis. This is why, to Keynesians, demand is the key: because everything starts from the general decline of demand due to the excessive savings of the population; in order to overcome the crisis, the demand must be forced to rise to normal levels.

Much of the Keynesian literature treats precisely this issue: what are the factors and levers that can determine and handle demand (Aligica, 2002: 74).

We can agree or disagree with Keynes' model and solution, but what is important here is that taking into account the objectives he has set, his solution is the most ingenious one. And just as important is to note that, in order to be able to articulate the model, he had not only to postulate a tendency of people to over-save, but at the same time, he had to deny the possibility that people might as well save. But under-saving (immediate

consumption of a higher share of the income, if not the entire income) is exactly the key to understanding the problems related to the formation and accumulation of capital. If the population spends with consumption everything that it has collected, capital does not have anything to form from. If instead it saves, it creates sources of capital accumulation (Aligica, 2002: 74).

This lack of interest in sub-savings was criticized from the outset by an author like Schumpeter, for instance. It was taken seriously into consideration only after sub-saving began to make its presence felt in countries where the influence of Keynesianism had stimulated it pragmatically, to the point where it began to seriously jeopardize capital formation. Moreover, it was found that due to the central location of capital in the process of economic growth, Keynes' system did not have too many really interesting and useful things to say to the countries that wanted to take the path of modernization and economic growth.

In Keynes' opinion, political vision precedes theoretical vision. It seems that *General Theory* was written in order to give a theoretical basis to economic policy statements that Keynes and other economists had formulated in the late 1920s (Beaud, Dostaler, 2000: 74).

Keynes opened many perspectives and his diagnosis is clear. The two biggest mistakes of capitalism, high unemployment and unequal distribution of income, are likely to favor revolution and to turn to fascism and Bolshevism. The persistence of high unemployment, as well as cyclical fluctuations of economy, is not conjectural phenomena, but the inevitable result of laissez-faire capitalism. These features result from the combination of a very weak marginal preference for consumption and investment volatility. This is itself the result of a very strong preference for liquidity and a very low marginal efficiency of capital, two phenomena leading the anticipations of the agents towards an uncertain future. *General theory* suggests a diagnosis of this complex and dangerous disease. Although he is in favor of maintaining a system of private enterprise, as well as income inequality, which he believed should not be completely excluded, Keynes said that the state is the only one able to take over the required investment, not only in order to stimulate effective demand, but also to ensure social utility. Thus, he argued, "I state that the state encouragement for capital investment, by using the most qualified technical force, in order to lay the foundations of large buildings and by credit and guarantees of the Treasury for their financing more boldly than before becomes an inevitable policy"(Keynes, 1970: 15).

Besides socialization of investment and planning and even the semi-socialism that this view involves, Keynes also resorts to a radical social transformation when he evokes the necessary euthanasia of the renter that may result from a gradual decline in interest rates. It is remarkable how Keynes attacked this parasitic unproductive class that lives from rents, which was also attacked, in a past time, by David Ricardo (Beaud, Dostaler, 2000: 76).

The era, in which the Soviet system appeared as an alternative to capitalism, provided hope for some, disaster for others, Keynes outlined, based on his diagnosis, several types of policy that should allow capitalism to overcome its own contradictions and thereby safeguard liberal society.

The application of the solutions, envisaged by Keynes for the economic problems of England, was denied in Keynes' own country, first in the years of the third decade, prior to the Great Depression of 1929-1933, and then during the crisis.

Instead, Keynes welcomed the program called the *New Deal* from Roosevelt's administration, which came to power after the presidential election in 1932. This program aimed to use civil public works as a means of winding down the mass unemployment that had emerged during the crisis. The policy of *New Deal*, one should note, had been born before Keynes' *General Theory* was published and public works seem to have been accepted and have been developed earlier, even before the period when Keynes advocated unsuccessfully on behalf of the officials, businessmen and professors of economics in England.

He also welcomed, after the outbreak of World War II, the war effort as an opportunity to verify his economic policy recommendations. Keynes hoped to finally see put in practice measures like those that he hadn't ceased to recommend for a decade and a half. There is no evidence at all that he would see the direction of state action in implementing his measures only in expenditures for weapons. Another aspect is that, in the postwar reality, the capitalist countries that applied a policy of Keynesian inspiration allocated, in some cases and in some periods of time, amounts of money for armaments production that almost equated to the investment in machinery and equipment.

Since 1936, Keynesianism has been developing in an autonomous manner; it no longer belongs to the man who conceived it. Meanwhile, Keynes has remained for ten years an actor and an active participant in this development. His positions, with their contradictions and variations, clarify the ambiguities that would characterize the development of this ensemble of doctrines and theories which will be described as Keynesian.

3. Internal and external theories of economic crises

After observing the interwar Great Depression, could economists answer the question: what is the economic crisis of overproduction? The economic crisis is related to the cyclicality of economic life, a key issue of macroeconomics. History shows that the economy does not evolve steadily, says the famous economist Paul Samuelson, author of a best-selling economics textbook. A few years of economic expansion and prosperity are followed by a recession or even by panic and collapse. The national product decreases, as well as profits and real income; the unemployment rate reaches very high levels; the number of people losing their jobs increases. Finally, Samuelson continues, a point is reached when decline is not possible and when economic recovery begins. Upward and downward movements of production, inflation, interest rates and employment form the economic cycle that characterizes all market economies and usually lasts between 2 and 10 years (Samuelson, Nordhaus, 2001: 656).

According to the same author, two theories exist that explain economic crises, internal and external theories. External theories consider the proposition that economic cycles originate in the fluctuation of factors outside the economic system, such as the occurrence of wars, revolutions and elections, the price of oil, the discovery of gold

deposits, the migration of populations, the discovery of new lands and resources, the advancing of science and the innovating of technology, even the presence of sunspots or weather. The external theory, Samuelson believes, is verified in the 1973-1975 recession, as well as in the case of recession in 1990-1991. Internal theories deal with mechanisms within the economic system that make economic cycles self-generate. According to these theories, expansion fuels contraction and recession, while contraction triggers the expansion of recovery supplies - in a cycle that repeats regularly. Some economists believe that, because consumers and companies had accumulated too much debt during the great economic expansion of the 1980s, the reduction of economic activity was inevitable. According to their opinion, the recession could be caused by any important, negative impact that the economy could confront, and the Persian Gulf War proved to be the appropriate shock at the right time (Samuelson, Nordhaus, 2001: 661).

Can economic cycles be avoided? Economic recessions have huge costs from an economic and human point of view, the fact that sometimes made economists determined to establish the objective of removing economic cycles. Such goals are too ambitious, Samuelson believes. An interesting point of view is that of Arthur Okun, who believes that recessions can be avoided like aviation accidents or hurricanes. But, as we cannot completely eliminate plane crashes, we do not have the wisdom or the ability to eliminate recessions. The danger has not disappeared, Okun warned us in 1970. Forces that cause recessions are lurking, waiting for the right moment to strike (Samuelson, Nordhaus, 2001: 664).

As we have previously mentioned, since the great crisis of 1929-1933 until the one that began in 2008, humanity faced other crises. But these were either local or regional, i.e. either not so extended or not having taken so much time and not having such serious consequences as the interwar one or the one we are facing now. We have to mention, between these, the energy crises of the 1970s, the Mexican crisis of 1995, the Argentinean one in 2002, the Japanese one in the 1990s and the Asian crisis of 1997 that affected countries such as Indonesia, Thailand and Malaysia.

What is very interesting is the fact that, like before the great interwar crisis, before the current global crisis, a number of public figures have expressed their very optimistic views about the future of the world economy. Thus, in 2003, Robert Lucas, professor at the University of Chicago and winner of the Nobel Prize for Economics in 1995, addressing the general meeting of the American Economic Association, said that the time has come that the domain moved on... The central problem of depression prevention, said the American economist, was resolved in all practical respects. Not only Lucas argued that the prevention of economic depressions was a solved problem. A year later, Ben Bernanke, a former Princeton University professor, who had left to serve on the board of the Federal Reserve, and then took the leadership of the Fed, after Alan Greenspan, spoke remarkably optimistically and said, much like Lucas, that modern macroeconomic policy solved the problem of the economic cycle, or more precisely, it reduced the problem to the point where it was more an annoyance than a problem of the first rank (Krugman, 2009: 13).

How can we explain that, although economics has greatly advanced in mathematics and although economists seem to understand the essence of crises and their remedies, crises cannot be avoided, resulting sometimes, in addition to economic consequences, in large popular discontent and resignation of governments that seem unable to cope with the economic and social problems that come as a flood in such periods. There are different answers to this question. What we think is that the official responses from some reputed American economists elude the truth, protecting exactly the institutions and persons directly responsible for the crisis.

4. Economic crisis and its prophets

The view of Charles Morris, expressed in his book *The economic crisis and its prophets*, is that the great American investors like George Soros and Warren Buffet, and officials like Paul Volcker, former head of the Federal Reserve until 1987, foretold the crisis many years before it occurred, unlike the reputed economists of the academic institutions of North America. The answer, Morris continues, is related to the state of the economy itself.

The ability to understand what goes wrong in the economy would not be so important if we considered the economist a kind of weather forecaster or stock market soothsayer. If a meteorologist says that it will rain today, we take an umbrella, but most of us ignore the weather report that covers more than a few days.

But the economic profession is really taken seriously. Companies set their spending and investment plans based on predictions made by economists and governments turn to these professionals to find guidance on a wide range of political issues.

Perhaps the key explanation to the problem we raised is to understand the limits of the profession and its dangers. Within recent experience, the two major schools of macroeconomics, taken broadly - Keynesianism and the Chicago School - have spawned every economic policy whose consequences have been devastating.

The Great Inflation of the 1970s refuted the neo-Keynesian theory of economic management in the 1960s. And when the turn came for the Chicago School, it led to spectacular financial engineering and anti-regulatory zeal to the point that nearly destroyed the Western financial system (Morris, 2010: 124). Which economic theory is the one that can cause such destruction, asks Charles Morris?

Modern mathematical economics emerged in the late nineteenth century and early twentieth century. The recent achievements in physics seemed to promise a perspective in which a wide range of human activities went under the control of science. Of all the social sciences, economics presented the closest reflection of physics. In the idealized example of a corn auction, thought up by the British economist David Ricardo, fair prices resulted from the statistical interaction of numerous atomistic market participants who obeyed the simple rules of rational self-interest. It looked exactly like, as in the case of James Clerk Maxwell's gas, the complicated and arbitrary dance of countless molecules in free collision that was coordinated only by a few simple and immutable laws. In the book of Alfred Marshall, *Principles of economics*, the basic manual

of economy in most of the period before the Great Depression, he wrote about differential calculus - the mathematical method of line curves that supports Newton's laws - that represents the universal formula, even in the fields of sociology and biology, and particularly in economy (Morris, 2010: 125).

Not everyone accepted that argument. Some well-known economists have pointed out that, in fact, it happens frequently that prices do not respect the curves in the model- they could be rigid and varied in jumps and did not increase in infinitesimal movements like Newton's apple. But U.S. scientists have embraced the theory, even in areas far beyond economy, such as psychology.

Although Keynes was a good mathematician, he was among the few consistently skeptical of scientific claims of economics. Keynes 's biographer, Robert Skidelsky, suggests that the former appealed to an older pre -mathematical type of political economy, like that of Mill and Hume, which considered society and exchange trade systems as a body, rich in assumptions and practices that could not be included in the models. He also understood that, although the basic equations of physics do not change, the ones of economy can sometimes become very unstable. Keynes made the famous observation that "in the long term we are all dead" during an argument against the value of long-term economic forecast. The variability of the basic relationships in the economy, he said, was likely to turn extensive projections into something very uncertain. And he was extremely skeptical about imposing heroic sacrifices for the sake of the distant benefits promised by economists.

Keynes's best known work, to which we referred in detail above, *The General theory of employment, interest and money*, includes a minimalist mathematical system. But Keynes's theory was widely accepted in academia, after the British John Hicks and the American Alvin Hansen had developed a mathematical model based on the main argument of the book. The increasing capacity of postwar computers has led to the constructing of neo-Keynesian macroeconomic models. In particular, American academics have created a rigid mechanical vision of the economic system. Operate this lever and investment will increase, turn that wheel and consumption will increase - all items will be in their places without problems, like steel tambourines.

The eclipsing of neo - Keynesianism in the context of the inflationary failure of the 1970s led to the rehabilitation of the old neoclassical economics associated with the Chicago School and to the explosion of new theories under the umbrella of the new classics. There is also a link between the new classics and the financial theorists of efficient markets at the University of Chicago. This business school housed, among others, Eugene Fama, Merton Miller and Myron Scholes, who have done most of their work on the theory of modern portfolios and the mathematical system of derivative instruments. Until the 2000s, academics with a similar thinking came to dominate most American schools of finance and economics and all firms on Wall Street. But amid newly spread theories, the objections raised in the early twentieth century remained valid. Financial markets, at least in times of stress, were not characterized by the line curves presented in the model (Morris, 2010: 126).

In the recent disaster of loans, we can find an argument for the fact that economic modeling practices contributed to the excesses of debt whose implosion caused the financial chaos around us. The market concept underlying most macroeconomic models of the new classical school is the so-called Arrow-Debreu economy. It is the type of economy without problems, perfectly able to unlock itself, dreamt of by all economists of the Chicago School. But its special feature is the concept according to which markets are complete - any asset or risk position can be converted without trace into a contingent asset, i.e. a derivative financial instrument. The intuitive idea is that if there are derivative instruments with fair prices that cover all categories of risk, all risks will migrate to the most desiring and the most able to support them. Consequently, the whole system becomes more stable and robust. Conservative economists of the Federal Reserve had accepted this reasoning - they really believed that the explosion of derivatives in 2000 reduced the risk of a crisis. And this belief enabled them to ignore the vast accumulation of debt and the proliferation of products that no one understood. How was it possible, asks the same Charles Morris, for greed to reach such a scale without brilliant people like Ben Bernanke, to observe? The answer is that these people saw the world through a very particular set of lenses but magic glasses, whose lenses came from schools dominated by economic and financial theory. Markets seemed to have arrived in paradise, and everything was going as well as possible in the best of all possible worlds (Morris, 2010: 128).

In this way, Charles Morris, very smoothly absolves the guilt of the ones who seem to be directly responsible for the crisis.

5. Krugman on the current financial crisis

Another answer comes from Paul Krugman, awarded with the Nobel Prize for economy in 2008, the year when the global financial crisis started.

After a review of the financial crises in Mexico, Argentina, Japan and South-East Asia, Krugman analyzes the outbreak of the crisis from 2008 on Wall Street. The most responsible persons for the crisis, to whom Krugman refers between the lines, are Alan Greenspan, former president of The Federal Reserve between 1978 and 2006, and George W. Bush, president of the United States between 2000 and 2008. Even if he criticizes them indirectly, the causes that Krugman refers to are so complex, that it was almost impossible to avoid this crisis.

Why, asks Krugman, did Greenspan become such a legendary hero? We need to mention that when he made one of his last appearances in front of the U.S. Congress, Greenspan was honored like some kind of Messiah of money politics. The 1970s and the beginning of the 1980s were an age of unpleasant shocks, of inflation and high unemployment, and of the worst declines since the Big Crisis. In contrast, the Greenspan age was relatively clear of these troubles. Inflation was low, and the two recessions during his mandates were short time issues, lasting not more than 8 months. In what concerns the financial investors, Greenspan years were paradise-like: the Dow index flew above the 10000 threshold, and its share prices increased by 10% a year. But, Krugman believes that Greenspan benefited from a favorable economic situation, in which the main character was Paul Volcker, president of The Federal Reserve in the

previous mandate. Volker brought inflation under control, achieving this goal with the expensive money policies, which caused a severe economic decline, but in the end, defeated the inflationary psychology. And after Volcker did the hard and unpopular work, Greenspan lived comfortably in the halo of great results (Krugman, 2009: 161).

Although Greenspan warned about excessive exuberance, he practically didn't do anything to fight it, Krugman says. The former president of The Federal Reserve used the phrase 'irrational exuberance' in a speech in 1996, in which he suggested, without saying the words, that there was a speculative balloon in stock prices. But he didn't increase the interest rate to temper the market enthusiasm; he didn't even try to impose a margin requirement for the market investors. Instead of this, he waited until the balloon cracked, which happened in 2000, and then he tried to clean up the mess that he had left behind.

Krugman claims that Greenspan was the leader not only of one, but of two huge speculative balloons, first the one of the real estate market and then the one of the housing market.

An uncontrolled optimism made the stock market flood with more and more funds, prices increased, and the speculative balloon expanded limitlessly. The stock asset balloon is a kind of natural Ponzi scheme, Krugman believes, a pyramid game, in which people continue to earn money as long as it attracts losers to it. But in the end, when there are no losers, the pyramid collapses. The summer of 2000 was the top of the stock market, and during the next two years, stock prices fell by 40% (Krugman, 2009: 169).

The real estate balloon was less justified then the stock balloon in the previous decade. House prices started to fall, and the interest rates were very low, in the beginning of the 2000s, and thus, buying houses became very alluring. When prices started to rise more and more, individual families hastened to enter the market, without thinking how they were going to pay later. More largely, though, it was stimulated by a change in lending practices. Buyers were given credits with low or zero advance and monthly payment rates that far exceeded their possibilities of repayment or became impossible for them to honor once the small interest rate, used as bait, returned to normal.

Although some economists warned about a large-scale speculative real estate balloon, and that its collapse would expose the United States economy to serious risks, Alan Greenspan affirmed that any major decline in the evolution of house prices would be extremely unlikely, admitting that there might be some speculative bubbles on the real estate local market, but in no case a nationwide balloon.

Krugman claims that, after the balloon collapsed, the economy of the United States fell into recession. Greenspan then aggressively lowered the interest rates and quickly saved the situation, changing the recession into a short superficial one, without a large decline in GDP, which ended after only 8 months. Officially, the recession was very short, but the labor market continued its way to ruin a long time after the recession was officially declared over. When the money policies began to gain traction, it happened through the real estate market. What happened? Greenspan was only able to replace the stock market balloon with the real estate market balloon. And the question was: What will

happen when the real estate balloon will crack. The FED (The Foundation for Enterprise Development) barely managed to pull the economy out of depression after the stock balloon, and this happened because another speculative balloon appeared in its wake (Krugman, 2009: 175).

What Krugman tells us is, in fact, that the signs for the world crisis emerged, in the north of the United States, a few years earlier than 2008.

Another problem that Krugman insists on is the so-called shadow banking system. As a result of the Glass–Steagall Act, the U.S. banking system underwent bank separation into two categories. On one hand, this contains the traditional banks (commercial banks, which receive deposits), and, on the other hand, the investment banks. The commercial banks were subdued to (after the great postwar crisis) some rough restrictions concerning the risks that they were allowed to assume, instead they had prompt access to credits from the FED. Investment banks had imposed far laxer regulations, but they considered it acceptable, because investment banks didn't receive deposits and had no reason to be subjected to massive withdrawals.

Banks are subject to a high degree of regulations, and are required to maintain cash reserves, to have substantial capital reserves and to contribute with money to the deposit insurance system. Raising funds by making bid interest securities (a tradable financial instrument invented in the Lehman-Brothers investment bank in 1984), lending institutions were able to circumvent these rules and costs. This also meant that bid-rate securities were not protected by the safety net of the banking system.

The bid-rate securities system, which at its peak period had in game over 400 billion collapsed in early 2008. One after the other, auctions failed, as fewer investors let the existing investors pull their money out of the system. People who thought they had immediate access to their money, suddenly found out that their money was blocked in large investments stocked on a few decades, of which they had no way out. Each auction, thus, failed and led to the failure of another. After people had seen the dangers of these super-intelligent investment schemes, no one wanted to invest more money in them (Krugman, 2009: 183).

This story makes us think about the warning launched in David Korten's book, *Corporations rule the world*, which had been published in 1995, long before these bad things happened in the U.S. financial system. Here is what David Korten tried to warn us.

Although, in some circumstances, speculators' claims that their activities that enhance market liquidity and stability have some coverage, these sound false in the context of increasingly volatile global financial markets, in which the speculative financial movements are a major source of instability and economic failure. Moreover, Korten continues, regardless of the contribution of speculators to the increased efficiency of financial markets, it is made with a considerable cost in relation to profits and to fees that they extract. The class of financial instruments called derivatives is a very important source of concern. Derivative contracts involve betting on fluctuations in stock prices, exchange prices, interest value, and even the stock market indices in their entirety. The total value of the most important derivative contracts was estimated to be

about 12,000 billion in mid 1994, with a projected increase to 18 trillion by 1999. To get an idea of these sums, we can add that in 1993, *The Economist* magazine, estimated the world reserve of fixed production averages at about 20 trillion dollars. What makes derivatives to be risky is that usually they are purchased with margin. This means that the original purchaser opens only a small insurance deposit against the potential financial risk. Larger competitors might not be conditioned to opening any deposit, although their potential financial risk could amount to hundreds of millions of dollars (Korten, 1995: 226).

If this was the case of financial instruments in 1994, let's see Timothy Geithners's declaration from 2008 as the president of the Federal Reserve Bank of New York where these instruments led to in the pre-world crisis period. Geithner highlighted the fact that the structure of the financial system changed fundamentally during the momentum, with a dramatic increase in the proportion of its assets outside the traditional banking system. In early 2007, Geithner continues, asset-backed commercial circuit effects in structured investment vehicles, in preference securities acquired assets in municipal bonds with option to purchase the acquired assets and promissory notes payable on demand, had a value combination of approximately 2.2 trillion dollars. Assets financed with loans on day through redemption arrangements increased to 2.5 trillion dollars. Assets held in hedging funds grew to roughly 1.8 trillion. Combined balance sheets of the top five investment banks in the United States, during the same period, were of only 6 trillion dollars, and the total assets of the entire banking system was around 10 trillion dollars (Krugman, 2009: 185).

In other words, Krugman noted, Geithner considered a range of financial arrangements in a non-bank financial system. That is things that were not banks, in terms of regulatory legislation, but yet fulfilled banking functions.

After the outbreak of the economic crisis, there were some accusations or, as the American economist says ironically, a hunt for guilty ones.

Some right-wing accusations, unfounded ones, believes Krugman, refer to the fact that all those problems would have had the benefit of the law to reinvest on behalf of communities, which are alleged to have forced banks to give loans for housing to buyers from disadvantaged minorities who then didn't paid their dues. Conservatives, continues Krugman, blame Fannie Mae and Freddie Mac, government-sponsored lenders who were pioneers of the real estate speculative balloon and the fragility of the financial system.

Some economists blame deregulation, specifically the repeal of Glass–Steagall Act in 1999. This gesture allowed commercial banks to engage in investment banking operations and thereby assume more risks. The truth, Krugman thinks, is that as the shadow banking system expanded, rivaling in importance or even surpassing that in traditional banks, politicians and government officials should have realized that the kind of financial vulnerability that made the Great Depression possible was reinvented – and they should have responded by extending the regulations and the financial safety net, in order to cover these new institutions (Krugman, 2009: 188). On the contrary, Krugman

notes, the zeitgeist and the ideology of the George W. Bush adminstration were deeply anti-regulation.

We are reminded of scenes from the documentary *Inside Job*, which appeared after the outbreak of the global crisis, revealing that all these facts had been known in the world of American economic and political elites, but they did nothing and nobody wanted to do anything related to regulations, because, in this way, the elites had made fortunes of hundreds of millions and even billions of dollars. The sad truth is that these people, in the shelter of comfortable wealth, living in a parallel world to that of ordinary Americans, do not care about the crisis. They don't care about the people suffering and losing fortunes, houses, jobs... they don't care about the tent cities that have emerged in some areas of the United States, after millions of Americans lost their homes. They also don't care about the millions of people in other countries affected by the crisis. Not to mention the fact that they have an attitude of defiance when asked whether or not they assume the fault for the crisis...

The crisis that broke out in 2008 led to a global decline, Krugman notes. For a decrease in housing prices has a direct negative effect on employment by lowering construction activity, and tends to lead to a reduction in consumers' spending, because people feel poorer and they lose access to credits based on the collateral represented by their house; these negative factors have a multiplying effect, as the decline in employment leads to further decreases in the volume of expenditures.

The financial collapse, continues the same Krugman, seemed to transform what seemed an ordinary recession. The credit crisis intensified after the collapse of Lehman Brothers. The sudden crisis in emerging markets, the collapse of consumers' confidence from the moment when the magnitude of the financial calamity reached the headlines of newspapers, all come to indicate the worst recession in United States history, and in world history, as a whole, since the 1980s (Krugman, 2009: 207).

What solutions are required to overcome the global economic crisis?

Noting that credit contraction is behind the combination of lower confidence and decimated capital at financial institutions, the first solution, thinks Krugman, is to introduce more capital into the system, also called money growth. In fact, he continues, this is a standard response to financial crises.

Other solutions relate to what Krugman called traditional Keynesian fiscal stimuli. In other words, tax cuts with no more than four percent of GDP, supporting and expanding public expenditure and long-term reform of the financial system, but unfortunately the U.S. economist does not tell us how we should do it. A solution, which is basically an invention of Krugman, is determining authorities to temporarily pursue direct lending activities of the non-financial sector.

6. A Critique of Krugman's view

In an unpublished manuscript, Gheorghe Olah, a professor in macroeconomics at the University of Oradea, criticizes the measures advocated by Krugman. What is this criticism basically? As he notes, the three solutions are actually all Keynesian. Only the

fourth is original. The main idea that dissatisfied the economist from Oradea is pumping money into banks. Why? Because Krugman makes the statement that one thing that can bring an economy out from the liquidity trap is expanded inflation which discourages people to place money under the mattress. On one hand, economists argue that monetary policy measures do not produce an effect unless they are unexpected, and then only in the short-term (Olah, 2011: 7). On the other hand, as people observe and understand them, they react inversely to them than the governments' preference. Finally, the expected inflation suggested by Krugman as a solution to determine people to spend more money by buying more, in order to increase the demand in this way and to find the way out of the crisis, will lead them, Gheorghe Olah believes, to convert the money into another currency or a more secure value or goods such as houses, land, gold, paintings, etc. as experience has showed us.

What kind of growth can also generate such purchases, asks the economist from Oradea. Would Krugman spend so as manager of his own personal resources? Krugman supports his conviction by applying any of the standard mathematical models that economists use in conventional monetary policy analysis. Mathematical models can say what they want, the reality seems to be stronger than any model, and it always shows that it is inevitably followed by crisis or recession, Olah concludes.

Here's further proof that the economy, as a social science, can hardly be saved by mathematical models. Perhaps these models can be applied in periods of macroeconomic stability. But in times of crisis or instability, mathematical models seem to be as useful as a Ferrari car on a dirt country road here in Romania. Here, we are in the area where the hyper-mathematized economy meets its own limits.

7. Solutions for the current economic crisis

A very interesting paper that examines the economic crisis in Romania as part of the global economic crisis is signed by Liviu Voinea, *The End of illusion economy*. After the author extensively analyzes the causes of the global economic crisis and the peculiarities of the economic crisis in Romania, the economist from Bucharest examines the anti-crisis solutions taken by many national economies, but especially what was done in this regard in Romania and what should be done next. The first country to take anti-crisis measures was the United States. The measures taken by the U.S. include the discount window, the direct injections of capital into financial institutions and the direct increase in private lending by state-owned companies (Voinea, 2009: 55). On the other hand, the recovery plan and the investments of Americans included tax incentives and erasing debts for small businesses, family benefits, reduced VAT on the sale of new cars, an additional $ 250 to each recipient of social welfare, a fiscal credit of 8,000 dollars for those who purchased a house for the first time, $ 54 billion for public schools, tax reductions totaling $ 17 billion for renewable energy use and more than 100 billion dollars for increasing the coverage of medical assistance. Thus, the state pumped over $ 700 billion into the private economy. The most liberal economies in the world, the American and British ones, nationalized numerous financial institutions under the guise of saving small investors, but actually covering the huge financial losses made by the management of these institutions. Great Britain introduced a stimulus package worth

30 million dollars, focused on investments in technology and the use of human capital, but also on the reduction of VAT from 17.5 % to 15 %, partially offset by the increased income tax from 40% to 45% for the richest 1% of the population (Voinea, 2009: 57). On the other hand, Germany implemented a stimulus package of 50 billion Euros consisting of investments in infrastructure, tax cuts, increased allowances for families with children, as well as a bonus of 2,500 Euros for those who change their old cars with new cars.

Developed countries could implement fiscal stimulus packages worth of tens and hundreds of billions of Euros, a luxury that emerging countries (including Romania) could not afford, because of the difficulty of financing deficits and because of the pro-cyclical policies adopted during periods of economic growth (Voinea, 2009: 153). In addition, Liviu Voinea believes, both the causes of the crisis and the mechanisms for overcoming the crisis should be different. In Central and Eastern Europe, whether it was with or without the IMF loan, the same philosophy was applied, based on fiscal austerity measures. Thus, in Bulgaria, the measurements were the freezing of budgeters' wages, the lowering subsidies and investments, and the decrease of up to 10% of all expenditures. In Hungary, these meant eliminating bonuses for state employees, freezing wages in the public sector, freezing pensions and some social benefits, reducing subsidies for gas and housing, reducing of allocations for families and of sick leave, increasing thr VAT. Romania resorted to the reduction of the wage fund in the public sector and to the limitation of bonuses, the increasing of health insurance contributions and the introduction of minimum tax on business figure (Voinea, 2009: 156).

These anti-crisis measures, Liviu Voinea believes, represent a typical orthodox, monetarist approach, which has its merits, particularly in terms of sustainability of short term deficit, but involves, in a first phase, a deepening of recession, because fiscal austerity is achieved at the expense of economic growth. Less money means less consumption, less inflation and less imports. The strict monetarist anti-crisis recipe, Voinea concludes, cannot pull the economy out of crisis. It can bring it back afloat, but after a certain period of time and with significant social costs, without having to offer a healthy base for medium and long term growth.

Liviu Voinea proposes several solutions for overcoming the national economic crisis. Summarized, these are resuming lending and stimulating consumption, increasing public investments in infrastructure, increasing employment and enhancing the use of Structural Funds. On the other hand, the economist from Bucharest believes, anti-crisis solutions mean pragmatism and pluralism, application of policies that can work on a case by case basis, without giving them intrinsic ideological value. Social and environmental objectives are also needed. Solidarity, says Voinea, does not mean that everyone suffers equally from the crisis, but there should be a redistribution towards the most vulnerable social groups (Voinea, 2009: 165).

In this spirit, we believe, social economy represents, in its turn, a solution to the crisis for the most vulnerable groups of society, such as Roma, rural youth, youth coming from orphanages, disabled persons and single parents. The global economic crisis stressed the poverty and social exclusion of these groups. The repercussions of the

financial crisis on poverty are major and display trends of aggravation, particularly as the measures of social protection are shy and marginal (Pavel, 2011: 73). As Cace, Arpinte and Cojocaru put well, social economy exists in order to meet the human needs of those excluded by the dominant system of market capitalism. It is like an economic and social museum where the historical struggle of different societies in response to specific economic problems is available for anyone to see (Cace, Arpinte, Cace and Cojocaru, 2011: 53). Social Economy could be defined as the type of economy that efficiently blends individual responsibility with collective responsibility in order to produce goods and/or deliver services, that has in view the economic and social development of the community and whose main purpose is the social benefit to its members (Stănescu, 2013: 144). But what is the difference between social economy and liberal economy, asked Osvat, Stefanescu and Jurj. They believe that while liberal economy relies mainly on the production of individual profit, focusing on financial efficacy and profitability, the social economy is oriented towards supporting the social values, focusing on integration and accomplishment of the social needs existing within a given context (Osvat, Ştefănescu, Jurj, 2012: 540). Social economy, which, historically speaking, emerged in the 19th century in Europe as a response to laissez-faire capitalism, penetrated Romanian public consciousness through the social policies of the European Union and its consolidation is closely related to European funds (Pavel, 2011: 74). In each European country we meet different practices of social economy which refer to a broad range of establishments with different forms of organisation (such as associations, cooperatives and foundations, mutual aid units) (Nicolăescu, 2012: 130). Social economy, considering also Arpinte, Cace and Cojocaru, became known in Romania after 2007, the year when Romania was accepted as a new member of the European Union. Consistent funds were allocated to the development of the social economy for: stimulating job creation and developing aptitudes, consolidating the community's capacity for social support, supporting the economic growth and reviving the neighborhoods, and mobilizing disadvantaged groups (Arpinte, Cace, Cojocaru, 2010: 65). Social economy in Romania comprised in 2010: 2,179 institutions of mutual help, 2,128 cooperative societies, 51 credit cooperative banks and 419 authorized protected units.

Social economy, believes Raluca Popescu, plays an important role in solving economic and social problems, providing services whose demand is not adequately covered by the private or public sector. Gradually, continues Popescu, social economy has become a sector that generates more jobs in Europe. Thus, in 2005, at the level of EU-25, social economy covered 4% of GDP and involved over 11 million people, representing 6.7% of the total workforce employed at that time (Popescu, 2011: 27).

Vulnerable groups are considered a target, in which social economy can play an important role. The specific objective of social enterprises is to promote the social inclusion of groups in need by increasing employment opportunities. Meanwhile, social enterprises offer personalized services, ensuring the transition from a state of vulnerability to a normal labor market.

But we should stress that social economy in Romania has had a difficult beginning with a lot of problems. In the next years, the actors involved in this phenomenon will have

to struggle responding to these difficulties. We will mention a few of these problems. Firstly, the Framework Law of the social economy cannot solve in a satisfactory manner the problems identified in the development of this sector. So, it is necessary to adapt a broader set of normative acts. They currently regulate the activity of organizations, which have the potential to run social economy activities (Cace, Arpinte, Cace, Cojocaru, 2012: 54). The lack of regulation creates difficulties to the promoters who run social economy projects. The concept of social economy enterprise does not exist within the active laws, while some promoters undertook to establish such enterprises by implementing projects financed from the structural funds. Another problem is the lack of consistent forms of fiscal support, which may deter social economy initiatives addressing disadvantaged groups running a high risk of social exclusion. Given the lack of facilities, it is difficult to develop social services, which provide necessary support for the target groups. Under these circumstances, the economic activities tends to become inefficient in terms of the profit which can be generated and, therefore, they are vulnerable in the competition with the usual commercial companies, which provide similar goods (Cace, Arpinte, Cace, Cojocaru, 2012: 56). Other problems noticed by Cace, Arpinte and Cojocaru are the lack of subsidies, and the excessive taxation for work with no clear differentiation for beneficiaries of social services. They conclude that these problems will deter the initiatives of professional reinsertion and will maintain the vulnerable groups within the area of the beneficiaries of free social services.

Social economy could be a solution to the current economic crisis given the fact that jobs are created for people with high difficulties in integrating into the formal labor market. We believe that social enterprises created through EU-funded projects represent an appropriate response to the problem of poverty and social exclusion in societies with emerging economies and particularly in Romania. But the key to a successful social economy is in the state level. The Romanian Government and the Romanian Parliament could facilitate the initiatives that exist in the field of social economy. There already is a large volume of initiatives for income generating activities. But they are still insufficiently exploited, or they have little odds to become sustainable. The difficulties mentioned by the NGOs in the research conducted by the Institute for Quality of Life in 2010-2011, could deter such initiatives and block the attempts to initiate the development of social economy (Cace, Arpinte, Cace, Cojocaru, 2012: 60).

As we have noticed there are many solutions as response to the current economic crisis. Most of them are Keynesian type solutions. There is also the very interesting and promising solution of the social economy. But this is still a promise. It is necessarily a collective effort of specialists and authorities in the finding and implementing of this successful recipe.

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