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SOME NOTES ON THE INTERNATIONAL ECONOMIC CRISIS

Abstract

The paper investigates practical aspects of international economic crisis. How it does began, what was the s first signs of it in USA. Also this paper investigates reasons and lessons of Great Crash in 1929. Author tries to analyze World economic output and to find ways out from the crisis situation in international economy.

Key words:

Economic crisis, globalization, new economy, rate of interest, commercial banks, Federal Reserve, derivatives, world output.

JEL: G10.

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1. The happy years of globalization

It is not so important to fix the precise moment at which the crisis started. Even in the happy years of the *New Economy* in the United States and the good performance of the world economy, here and there, many observers had pointed out the weak aspects of what people liked to call «gobalization». For some decades the world economy has been governed by the rules of the *Washington Consensus*, meaning the consonant attitude of the International Monetary Fund (IMF), the World Bank (WB) and the United States Treasure Ministry.

The «rules of the game» inspired by them have been a reassertion of free trade mechanisms, overshadowed by the Keynesian interventionism along many years after the World War II. The main messages coming from this neoliberal stream can be summarised under the headings of: deregulation, internal and external liberalisation for capital and goods (not so much for labour), very cautious monetary policy, zero-budget policy coupled with regressive fiscal policies, floating of exchange rates, limited international coordination, weakening of Trade Unions' presence, underestimation of global public goods and so on.

An eloquent synthesis of this attitude has been the idea to activate a *trickling down* mechanism; its proponents claimed that it will promote new investment and economic growth, thereby benefiting not just those well-placed in the market but also other people. More specifically it is expected that the *trickling down* mechanism can lead to a great increase in the income produced, most of which will certainly go to those who hold a powerful position in the market, but it will also spill over to the poorer classes.

Growth will certainly give these classes a chance to be better off, even to escape from poverty, although it does not necessarily lead to greater interpersonal equity in the system. On the other hand, the mechanism should not be obstructed by measures for redistribution which are intended to reach greater equity, but can actually undermine the objective of efficiency: in the end, efficiency and equity are, from this point of view, opposite objectives to some extent.

In fact, the empirical evidence has really shown a world economy, growing rather steadily for many years, driven by the large economies of the incumbent United States and of some «newcomers», above all China and India. At the same time, however, the results, in terms of equity, have not been so positive: the absolute poverty, as such, has been sensibly declining in many countries, but the data on relative poverty have been the clear testimony of a disappointing outcome in terms of equity.

This topic has been dealt with in a paper of mine, recently published[1], where the contradictory aspects of the recent process of globalization have been considered, relying on the extent of the literature producing a critical vision of that process. This paper contained, for instance, a list of significant «failures» emerging behind the screen of the optimistic image, traced by the convinced supporters of the globalization; it can been worth while to recall them briefly, because they can be a useful background to the discussion of the present crisis[2]:

1. numerous financial crises: Mexico (1994–95); various Asian countries (1997–98); Russia (1998); Brazil and Turkey (1999–2001); Argentina (2001); United States (2007);
2. United States economic policy that has been characterised for many years, in full Keynesian tradition, by a very high budget deficit, financed by other countries, including China;
3. asymmetrical liberalization of the movement of goods, as expressed by the conflict between developed and developing countries;
4. limped liberalization: trend towards free movement of goods and capital, accompanied by restrictive policies on the movement of people;
5. inadequacy of the quantity and forms of aid;
6. an enormous amount of Foreign direct investment (Fdi), making some economies too dependent on the policies of multinational corporations;
7. scandalous episodes of illegal and/or greedy behaviour by either owners and/or managers of some of big corporations, which have forced governments to rethink the rules of corporate governance;
8. greater attention given to the so-called Global Public Goods (environment, health, and so on), asking for more coordinated strategies, run by governments rather than by the market forces;
9. persistence of, and in some cases, increase in inequality between countries and within countries.

Among the signs of this inequality a specific mention was given to the spreading of the *working poor* in the United States and elsewhere. It is the case of a large amount of unskilled workers, experiencing an absolute and relative decline of their standard of living, within the contest of a growing international integration. A decline, on the other side which has been going along with an increase in the emoluments of skilled workers, particularly impressive in the case of managers.

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[1] See Tiberi M., *Poverty and inequality in the age of globalization*, «Journal of European Economy», December 2007.
[2] *Ibidem*, pp. 375-6.

The above mentioned aspects, and some others could be added, were not ignored by the neoliberals, who were led to consider them as minor disturbances with respect a successful path followed by the world economy; then some underestimation, in the 2007 Summer, of the first signs of a financial crisis in the United States is not surprising.

At the same time, some shifts in the attitude of some scholars and representatives of important international institutions took place; general and specific messages recipes had been produced as indicated in the already quoted paper of mine[3]. As an example of that shift it is possible to remember the *Millennium Declaration* of the General Assembly of the United Nations in September 2000, containing the idea of introducing some corrections to the current course of events in order to achieve some important social and economic targets (*Millennium Development Goals*), explicitly mentioned, and this has been an appreciable change of method, in quantitative terms[4].

To some extent, however, it has been more significant of this innovation in the cultural orientation of the main international organisations, a passage of a *Report* of the WB, saying that: «... a broad sharing of economic and political opportunities is also instrumental for economic growth and development. This is for economic reasons, because greater equity can lead to a fuller and more efficient use of a nation's resources»[5].

Furthermore, the paper mentioned a large number of suggestions of different importance put forward by the «interventionists» in order to redress the behaviour of the economic systems, both at international and national level. This implied, in fact, the deep belief that the undoubtable widening of the internationalization of many economic activities, concerning goods, services, short- and long-term portfolio investments, foreign direct investments has not reduced the importance of an economic policy, implemented within the national boundaries. It is the case of, for instance: income policy, structure of the fiscal system, education policy, composition of social expenditure, research and development incentives, and so on.

As to the possible changes in the network of international institutions the emphasis has been directed towards a more democratic and transparent set up of the most important of them: Imf, WB, Wto and Ilo. This approach can be compatible with whatever will be the evolution of the world economic system, which is witnessing a visible dualism between regionalism and globalism[6].

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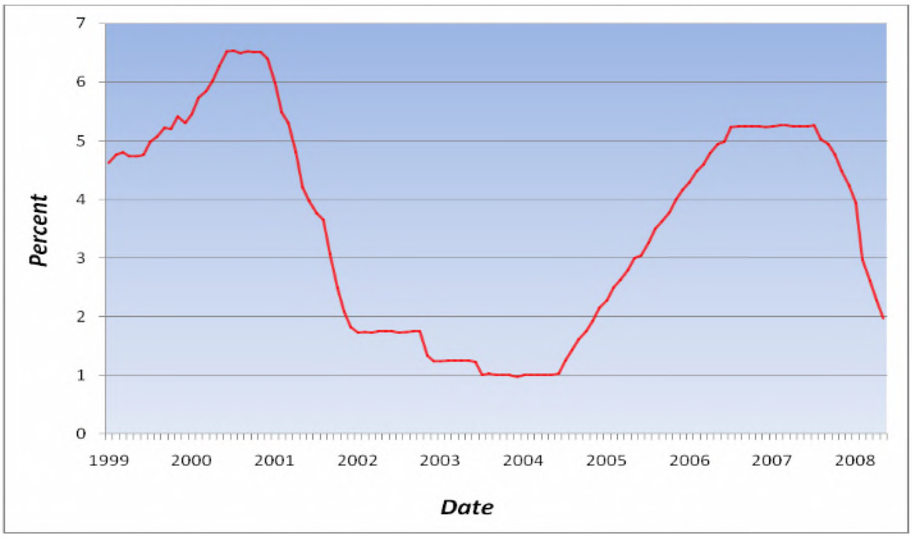
[3] *Ibidem*, 5.
[4] See http://www.un.org/millennium/declaration/ares552e.htm.
[5] See World Bank, *World development report 2006. Equity and development*, Washington, 2005, p. xi.
[6] See Tiberi M., *Poverty and inequality...*, pp. 368–9; 378–80.

2. The signs of crisis in the United States

We have previously mentioned the presence of weaknesses within a rather positive behaviour of the world economy before and after the end of the twentieth century; and some of them have to do with the the United States, the leading country of the recent strong tendency towards the internationalization of the national economies. Already at the beginning of the year 2001 a number of worrying elements were coming to light, undermining the solid image of the successful years of the *New Economy*[7] in that country. There were a stagnant production with a fall in prices; increase in unemployment; a large restructuring in firms of all dimensions; a sensible deflation of the «financial bubble» and so on. Then the political shock, produced by the terrorist attack of September, distorted the whole internal life and the proper meaning of any economic data.

Graph 1.

The behaviour of the rate of interest of the Federal Reserve



Source: our elaboration of Federal Reserve data (see *Web sites*).

[7] Rather than proposing a definition of the *New Economy*, one can say that it was characterised by the diffusion of information technology in many productive sectors, on one side, and the achievement of good results in terms of growth without inflation; see, among many other sources: Atkinson R. D., *Myths of the New Economy. Getting the parameters of change right*, «New Economy», vol. 7 (1), March 2000; Norton R. D., *Creating the New Economy. The entrepreneur and the US resurgence,* Cheltenham, Elgar, 2001.

However, after a short period, most of the relevant economic forces, operating since many years in the country were able to find a way to come back; a crucial role has been played to support this effort, according to many observers, by the «cheap money» policy conducted by the Federal Reserve (Fed), especially in the years 2002–04 (*see Graph 1*).

This choice, which must be considered in the light of the institutional mission legally assigned to the Fed, posing, at the same level, the two final targets of price stability and full employment, has certainly given the tune of «no liquidity problem» to the main operators in the economy. In this contest it must be remembered the importance of the housing sector, even in the most advanced economic system: in real terms, it employs a large amount of labour force but, apart from that, housing prices are essential in guiding, through the «wealth effect», the level of aggregate consumption[8]. Furthermore, a lot of financial activity is linked in terms, first of all, of mortgage loans, and also of all kinds of «derivatives»[9], that have been originated by them. It would be incorrect to treat this kind of assets as the «bad guys» of the markets, since there are good arguments to support their presence, at the same time it must be noticed the disturbing expansion of their quantities in the first years of this century (*see Graph 2).*

It has happened, therefore, that growing prices in houses and in many financial assets have been nourishing a remarkable expansion of the relative presence of the finance sector with respect to other variables of the economic system. The right attempt to spread the different size of risks connected with the loan process, the intermediation in the exchange markets and in the stock exchanges, has stimulated the innovative capacity of people employed in the financial institutions, among which many have become transnational companies. The unconditional trust in market adjustments have produced a rather general neglect of the proper amount of caution and control that must balance the extension of risky operations; the strong message of *deregulation* was extended to financial markets, lowering the barriers for institutional and self-managed rules. The marking of Credit Rating Agencies (Cra) played its part, issuing a large number of positive verdicts[10].

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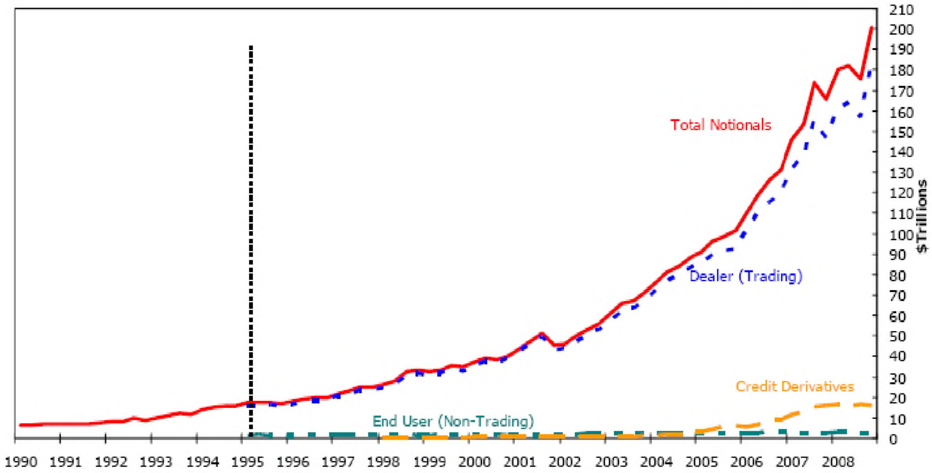
[8] On this point an original point of view can be found in Buiter W. H., *Housing wealth isn't wealth*, Nebr Working Paper No. W14204., July 2008.

[9] A definition, useful to our ends can call «derivatives…those products, the value of which **derives** from the course of the value of any asset or from the taking place of an objectively observable event»; that asset or that event is known as the **underlying**. Hedging, speculation and arbitrage are generally at the origin of derivatives. See http://www.consob.it/main/trasversale/risparmiatori/investor/prodotti_derivati/cosasono_prodottiderivati.html.

[10] «Blondinian» is a term that Caffè used many years ago, to describe the «present international financial order», making reference to an expression that D. H. Robertson used in his *Essays in monetary theory* (King & Son, London, 1940). See Caffè F., *L'economia contemporanea. I protagonisti e altri saggi,* Studium, Roma, 1984, p. 111. Robertson writes in a footnote (p. 144) that: «It appears somewhat to my surprise, to be necessary …to explain that Blondin was a famous tight-rope walker of the latter part of the nine-

Graph 2.

Derivatives Notionals by type of user. Insured commercial banks



Source: *OCC's Quarterly Report on Bank Trading and Derivatives Activities Fourth Quarter 2008*, Graph 1; http://www.occ.treas.gov/ftp/release/2009-34a.pdf.

Cheap money, easy access to credit, the limited amount of bankruptcies could be complementary to the positive behaviour of the real economy of the United States, entitled also to proceed with an uninterrupted series of current account deficits in the balance of payments thank to the financial support, above all, of oil-producer countries and China. Then banks and most financial institutions felt encouraged to push to the limit their credit activity, technically expressed by the «leverage ratio»[11]; «it was the most benign risk environment we had seen in 20 years»[12].

A specific aspect of this financial euphoria has been the large increase in the area of sub-prime mortgage loans, involving people, obviously wishing a house but with very weak credentials[13]. In fact the classification of potential

teenth century». It is our intention, of course, to recall this idea as applicable to the contemporary financial markets.

[11] The leverage ratio can be defined as the firm's total liabilities divided by shareholders'equity: D/E, where D represents liabilities and E the equity; it is clear that the larger is the ratio the riskier is the position of the agent being considered.

[12] *Confessions of a risk manager*, «Economist», August 9th 2008, p. 68.

[13] Although the housing market is the most relevant, it should not be neglected that the subprime people, employed in the weakest segments of the labour market and devoid of any patrimonial assets, have received loans to buy a car, a computer or other electronic devices, and so on.

debtors includes those indicated as prime, midprime and subprime; the last ones have been largely obtaining loans, charged, of course, by very high rates of interest. The level of risk deriving from this kind of operation has fuelled to a large extent the market for derivatives, through which all creditor institutions have tried to spread the risks to other financial operators (banks, insurance companies, hedge funds, pension funds, and so on) and also to the individual savers[14].

In spite of a number of financial crises already happened in the past, the huge amount of financial assets and liabilities has been considered as compatible with the functioning of market mechanisms by many scholars and persons covering prominent positions in private and public organizations. The «free banking» perspective, as declared by a supporter of this point of view, can be summarized as follows: «While most economists have long believed that government intervention is necessary to safeguard the banking system, he argues that such intervention is not only unnecessary, but positively counterproductive. Financial *laissez-faire* would be safe and stable… and government intervention actually undermines the market forces that make it so»[15]. Similar quotations can be found in many most recent bibliographical sources, because, as it has been noticed, the almost unconditional reliance on the interplay of demand and supply has inspired the «rules of the game» in the last thirty years.

It is also true that a more problematic approach has been emerging more recently elsewhere[16], and it is particularly worth noticing the case of some influential institutions, such as the Bank of Italy, whose Governor Draghi, had written, with regard to *derivatives*: «They can however become a cause for instability if they are utilised by intermediaries not to cover the existing risks, but to increase the risks to be taken. The *derivatives* can also affect the *modus operandi* of banks that make use of them; if those who gives a loan transfers partially the risk to others, the incentive to select debtors' quality can diminish; a signal comes from the increase in defaults in the mortgage market in the United States, where risk's transfers is widespread»[17]. It cannot be ignored, finally, that the pro-

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[14] Just as a sign of the importance acquired by this part of the economy in the United States, we can quote from a document prepared by one of the most authoritative international organizations: «High house prices and household debt burdens were identified as major sources of risk to future growth prospects, even as evidence emerged that the US housing market was cooling off. An important question for the Federal Reserve was whether such developments required a more restrictive monetary policy response than in the past, given that houses might have become significantly overvalued». See Bank for International Settlements (Bis), *76th Annual Report 1April 2005–31 March 2006*, Basle, 26 June 2006, p. 61. This phrase is helpful to understand the Fed's shift towards higher rates of interest since the end of the year 2004 (see *Graph 1*).

[15] This supporter is K. Dowd; see his *The case for financial* Laissez-faire, «Economic Journal», vol. 106, no. 436, May 1996, p. 677.

[16] Kose M. A. and others, *Financial globalization: a reappraisal*, Centre for Economic and Policy Research, Discussion Paper no. 5842, September 2006.

[17] See Banca d'Italia, *Considerazioni finali all'Assemblea Generale dei Partecipanti*, Roma, 31 maggio 2007, p. 6 (*our translation).* Mario Draghi was then also Chairman of the Financial Stability Forum (FSF), which was convened by G7 countries in April 1999 to

tagonists of this *securitization* of the contemporary economic system have been a large amount of clever people, very well paid, who have formed, together with the top managers of many companies, a consistent area of privilege in many advanced economies.

And it is not by chance that the traditional document delivered by the Bis in the same period, after an allusive argument on the previous main financial crisis in economic history, stated: «Against this background neither central banks nor the markets are likely to be infallible in their judgments. This has important implications. The implications for markets are that they must continue to do their own independent thinking. Simply looking into the mirror of the central banks' convictions could well prove a dangerous strategy. The implication for policymakers is that they should continue to work on improving the resilence of the system to inevitable but unexpected shocks»[18].

It is quite normal that in a market economy some microeconomic failures take place and their repercussions can be limited, adjusted by the market mechanisms themselves with the help, sometimes, of state intervention. However, when these failures become more intense and touch agents, which have a big size and in a crucial sector of the economy, as it is the case in the financial one, their spreading throughout the system can become inevitable. The sequence of bad events since June 2007 was so relevant that, in spite of some uncertainties at the beginning, it appeared clearly how the world was going to face a historical crisis.

An extraordinary machine, extending its activity in a large part of the international economy, used to work almost freely and at a high speed, felt obliged to activate its unused brakes to stay on track decently: initially, high losses are registered by two hedge funds managed by Bear Stearns, an American global investment banking, due to unpaid quotas of subprime mortgage loans. Something similar takes place in Germany, where IKB, a bank specialised in long-term financing, is also affected by the crisis as well as in France, with BNP Paribas, a leading transnational bank.

Two important Cras, Standard & Poor and Moody's, become aware of the situation and start a deep revision of their classification, which implicates many typical assets, Asset Backed Securities (Abs) and Collateralized Debt Obligation (Cdo), created by the market in a large amount. Some insurance companies, which have been attracted by the covering of high-risky financial assets of the type produced by subprime loans, are also hurt: well-known transnational companies such as Ambac and Fgic face a downgrading by the Cras. Furthermore, the stock exchanges, firstly suffering from the fall in the quotations of the shares of financial companies, see a similar behaviour in many other assets as the cri-

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promote international financial stability; special attention must be given to the temptation of *moral hazard* for people responsible of granting credits, mentioned by the Governor of the Bank of Italy.

[18] See Bank for International Settlements, *77th Annual Report 1 April 2006-31 March 2007*, Basle, 24 June 2007, p. 140.

sis reaches the real sector of the economy and a tide of pessimism determines a huge amount of sales of securities.

The list, especially if it is extended to the years 2008 and 2009, could be enlarged with many other items concerning all kinds of financial operators, mainly located in the United States but also in other countries, and it is difficult to select the topic moment, which can become the symbol of this global crisis[19]. By the way, we like to mention three episodes out of many, just to give the sign of the breakdown of the American financial system and also of the contradictory decisions taken by the American authorities, under the leadership of George B. Bush, a convinced advocate of a market economy.

The first refers to two companies, Fannie Mae and Freddie Mac, privately owned but with a government sponsorship, operating a large activity in support of mortgage loans; being dragged on into big losses by the collapse of that area of credit, they receive a huge help from the Treasury, which becomes an important shareholders of the companies: a type of intervention unexpected from a Republican Administration. In fact the Bush Administration appears more in line with its liberal standing, when, very shortly, Lehman Brothers, first of all a transnational investment bank, is abandoned to its failure, considered by some the most important one in world history, whereas, after an interval of a few days, the Administration comes back to interventionism, through a consistent purchase of shares, in the case of a big insurance company, the American International Group (AIG): evidently the failure of a company, exercising its extensive activity in the field of financial operations, raised doubts on concrete repercussions not only in the United States but also in financial international markets.

What can be expected in this situation is a «credit crunch»[20] which displays its effects in all directions, under the sign of a general tendency to «deleverage»: flows of credit from all kinds of financial institutions, both to firms and private consumers, come almost to a halt; inter-bank credit is also heavily subjects to tensions; to raise money through the stock exchanges becomes very difficult; healthy portfolios of individual savers and many financial intermediaries are suddenly affected by «toxic assets».

The other side of the story is represented by all sorts of attempts produced by the coming back of an interventionism reasserted by policymakers, once by conviction and an other by despair: the need to prevent a freightening rush to the bank from depositors, opening the way to a deeper systemic collapse and the attempt to limit the negative effects on real growth and employment are behind a long series of provisions taken at national, regional and international level (see 4).

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[19] Actually somebody has advanced his proposal: «The outbreak of the current financial crisis can be officially fixed as August 2007. That was when the central banks had to intervene to provide liquidity to the banking system». See Soros G., *The new paradigm for financial markets. The credit crisis of 2008 and what it means*, Public Affairs Ltd., London, 2008, p. xiii.

[20] See «Economist», August 9th 2008, pp. 63 ff.

3. What can be learnt from the 1929's Great Crash

3.1. From the crisis to the New Deal

It is not difficult in the case of 1929 crisis to recall it with the classical heading of the «black Tuesday», remembering the day, October 29, when more than sixteen millions of shares were sold and their value dropped of other ten billions of dollars[21]. Apart from this symbolic day, the Great Depression also had been preceded by a long period of success for the economy of the United States, which was called to be the world leader substituting for Great Britain, exhausted by the huge effort demanded by the World War II.

Of course quantities and qualities were strictly connected with the working of the economic institutions of the time; however it is possible to detect the signs of a misconduct in the behaviour of many operators: banks and financial institutions, not clearly distinguished in their functioning[22]; individual savers; regulators, and so on. Then those years saw a speculative boom, nourished by an easy access to money for people attracted by the chance to earn a lot of money through speculation in the stock exchange, Wall Street, which had become the most important market of the world. On the other side, in that phase, it does not seem possible to identify the extremely dangerous situation represented, in the recent crisis, by the subprime mortgage loans. At the same time, once again the housing market played a significant role in producing an economic bubble, embodying a high risk to blow up: after a series of ups and downs, at the end of October 1929, a decisive fall in stock prices opened the way to many years of depression in the United States and elsewhere[23].

It is not necessary to dwell on the amount of data that can inform on the relevant fall in the main macroeconomic indicators of the real performance of an economic system, while prices were driven down by a deflationary process,

[21] Actually a «black week» started from the previous Thursday, October 24. The given amounts can differ from one source to another, but certainly the losses were immense. Among the rich bibliography devoted to the *Great Crash*, it is worth mentioning the works produced by the incumbent Chairman of the Fed: Bernanke B., *Essays on the Great Depression*, Princeton University Press, 2005.

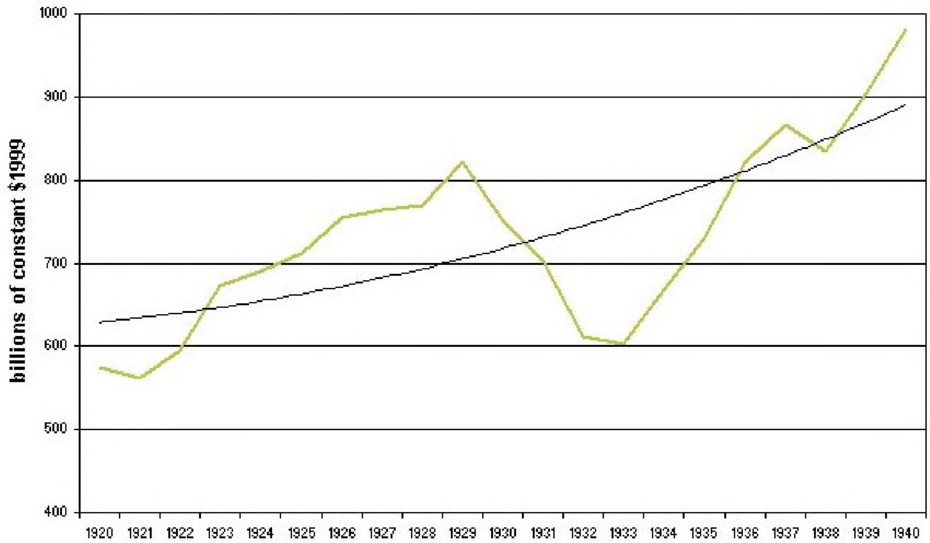
[22] Thousands of financial institutions, mainly banks failed in the period of the Great Depression.

[23] As it can be expected many works have tried to tell the story of the Great Depression; a necessarily limited quotation can mention: Brooks J., *Once in Golconda. A true drama of Wall Street 1920-1938,* Harper & Row, New York, 1969; Galbraith J. K., *The Great Crash 1929*, Penguin Books, Harmondsworth, 1961 (1954); Klingaman W. K., *1929: The year of the Great Crash*, Harper & Row, New York, 1989.

shown by a negative percentage rate of change in price level for all the years 1929-32, with a peak of -15,3% in 1931. At the same time, 13 millions of people lost their jobs, Gdp fell around 30% between 1929 and 1933; almost in the same period the industrial production fell by nearly 45%, whereas homebuilding registered the negative peak of 80%[24].

Graph 3.

GDP annual pattern and long-term trend, 1920–40, in billions of constant dollars



Source: based on data in Susan Carter (ed.), Historical Statistics of the US, (2006), Series Ca9.

Only at the end of the decade the Gdp of the United States could go back to the level that the country had achieved before the crisis, as it can shown in *Graph 3.*; and just with reference to this result it has been possible to read in an

[24] Data on the Great Depression can be found in many sources such as: Chandler L. V., *America's greatest depression*, Harper & Row, New York, 1970; Mitchell B., *Depression decade: from new era through New Deal, 1929-1941*, Rinehart, New York, 1947. It should not also forgotten the amount of suicides, which were committed in that period; different numbers and opinions have been shown on this argument; see Galbraith J. K., *The Great Crash* …, cit., 148–52 and http://fathersforlife.org/suicides/US_suicide_deaths.htm.

article, published by the «Economist», the following mixed evaluation of the *New Deal*: «If the criterion be Utopian, the achievements of the *New Deal* appear to be small….If the *New Deal* be compared not with the absolute standard of Utopia, but with the achievements of other Governments, the former adverse judgement must be modified. If it be compared with either the performance or the promise of its rivals, it comes out well. If its achievements be compared with the situation which confronted it in March, 1933, it is a striking success»[25].

It is interesting to devote some considerations to the behaviour of policy-makers, who were called to face a quite unexpected negative event. We should not forget that the prevailing mood was strongly in favour of market forces, without any tradition for a macroeconomic policy defined in terms of targets and intruments. Within this contest a contradiction has already been going on, because most countries, United States included, were ready to betray the principle of freetrade applying protectionist measures, when they thought it was necessary to defend both their balance of payments and home production.

It happened, then, that the Smoot-Hawley Tariff Act went through the Congress in June 1930, reinforcing the already existing barriers against competitive exports, especially coming from the European firms. This protectionist drive was followed by other countries, producing a remarkable fall in world trade for many years, reinforced by the wave of beggar-my-neighbour policy through competitive devaluations.

Actually, turning to the exchange rate was initially out of question for a country, whose currency was one of the pillars of the *gold exchange standard*; only after the devaluation of the pound in 1931, the amount of pressures on the dollar opened the way to the devaluation of the American currency in 1933[26].

Therefore the only macroeconomic instrument available to the country was monetary policy; however, by restricting the money supply when the crisis started, the Fed gave up the role of *last resort lender*, which would have rather called for an injection of liquidity in a system affected by a fall of confidence and this choice can largely be considered as an important factor for the deflationary turning of the economy, with falling prices by more than 20% in a few years. The cautious choice made by the Fed seemed to be determined by the influence exercised by the narrow views of the members of the banks, located in other decentralised states and sitting around the same table of the *Open Market Investment Committee* with the member of the Federal Reserve Bank of New York. When this *Committee* had the opportunity to increase the liquidity in the system, the precautionary feeling of those members inspired the final decision, consisting in the injection of *high powered money*, in a quantity considered inadequate

[25] See *The New Deal. An analysis and appraisal*, «Economist», 1937, p. 147.
[26] See Eichengreen B. *The gold standard and the Great Depression, 1919–1939*, Oxford University Press, Oxford, 1996.

by experts of the level of Friedman and Schwartz[27]. And the asserted capacity of market mechanisms to reverse the situation did not show itself for some years until Franklin Delano Roosevelt was brought to power in 1933 and originated the *New Deal*, an interventionist approach, clearly based on lack of confidence in that capacity.

The expression was introduced in the first speech delivered by Roosevelt[28], when he swore as President and it can be considered a political program around which to gather the large majority of the nation in order to recover from the deep economic and social crisis. Actually Roosevelt managed to involve a number of prestigious intellectuals, mainly recruited in the best universities of the country and attracted by that reformist program. An essential feature of it was an interventionist approach, which reversed the preceding *laissez faire* attitude[29], chosen particularly by Roosevelt's predecessor, Herbert Clarke Hoover. Given that, it is impossible to determine the extent of the influence exercised by Keynes's ideas, which were certainly known in the United States but they have not reached the more systematic definition presented in his *General theory* only in 1936[30].

It has been written that the political thought, which inspired Roosevelt, can be labelled as «militant liberalism»[31] because it was explicitly asserted the intention to reshuffle the American society, giving more voice and income to many people previously marginalized; at the same time, the ambition was to reform a society, already governed by capitalistic principles, with the consent of most of the ruling class.

From this point of view a very meaningful measure was the national *Labor Relations Act*, also known as *Wagner Act* from the name of Democrat Senator proposing it; the Act was intended to give workers more powers with respect to the employers, through the reinforcement of Trade Unions, the introduction of more rights in the labor legislation, the institution of the National Labor Relations Board to supervise the behaviour of all parts potentially engaged in social conflicts. The Act was passed in 1935 and could not rely on the expected positive answer from the employers, who conducted a strong opposition against it weak-

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[27] See Friedman M. and Schwartz, *A monetary history of the United States, 1867–1960*, Princeton University Press, Princeton, 1963, ch. vii. On this point, see also Ciocca P., *L'instabilità dell'economia, Prospettive di analisi storica*, Einaudi, Torino, 1987, pp.174-5.

[28] «I pledged myself to a **new deal** for the American people. This is more than a political campaign. It is a call to arms». See *The Roosevelt week*, «Time», July 11, 1932.

[29] It has just been remarked, however, the contradiction with this attitude, represented by the Smoot-Hawley Tariff Act, clearly in contrast with the principles of free trade.

[30] See Keynes J. M., *The general theory of employment, interest and money*, Macmillan, London, 1936.

[31] See Besussi A., *La società migliore. Principi e politiche del new deal*, Mondadori, Milano, 1992; the book includes an extended bibliography, where the literature, written in English, clearly prevails. In fact, all kinds of liberalism had some roots in the American cultural tradition, which, on the contrary, had not seen the emergence of a significant influence of the socialist thought.

ening the attempt to introduce more symmetry in the industrial relations. Employers' line implied also a legal battle through appeals to the Supreme Court Council, which sentenced to their favour in some cases.

However the first interventions after assuming power in 1933, the *Emergency Banking Act*, had to do with the monetary and financial sectors, where there was the need to restore confidence to reactivate the main flows among all operators. After a short period of Moratorium of banking activities, a controversial selection of banks, with failures and rescues, was put in place, new behavioural criteria were defined, a *Federal Insurance* on deposits was introduced, and the Fed was encouraged to function actively as *lender of last resort*[32].

The devaluation of the dollar was another part of the general reassessment of the national economy, in this case with inevitable repercussions in many other countries, for the influence on the amount of international liquidity and the relative prices of tradable goods, since the American currency had abundantly replaced the pound as the main means of payment. There was then a fall in the volume of foreign trade for about a decade, some restrictions in the movements of people through countries and a strong diminution in the amount of outflows of the United States; many financial institutions were completely or partially ruined. So the crisis, which had the deepest negative aspects in the United States, moved abroad touching many other countries and the most affected ones were those with the highest income per head[33].

The fiscal policy is an interesting chapter of the *New Deal*, because it cannot be ignored that there was an almost bipartisan tradition in the United States calling for a zero-budget deficit; Roosevelt himself was initially reluctant in removing this tradition in spite of his radical interventionist approach. Therefore, in the first years of his mandate the fiscal policy was considered rather an instrument for social justice than for anticyclical purposes: a clear sign of this point of view was the *Wealth Tax Act*, approved by Congress in 1935 and deliberately intentioned to smooth at least the peaks of the richest people in the country. There was also a general political support for all attempts from the Administration to reduce the level of evasion, which deprived the Treasury of a relevant amount of income[34].

An anticipation of the role of the Federal State in implementing the Keynesian «socialization of investments» was, in May 1933, the institution of the *Tennessee Valley Authority*, a new legal creation which tried to combine the use of a public good such as water, located in a specific region particularly hurt by the crisis, looking at the general interest of the country and relying on some degree of flexibility in the governance.

[32] See Nussbaum A., *Storia del dollaro*, Sansoni, Firenze, 1961, pp. 193 ff. Other important information concerning the American currency in the *New Deal* period can be found in this book.
[33] See Ciocca P., *L'instabilità ...*, *cit.*, pp. 172 ff., which includes some considerations concerning Italy.
[34] See Besussi A., *cit.*, pp.154 ff.

Later on, there was a main shift in the use of this fundamental tool of macroeconomic policy as a part of what has been the guidelines lines followed by Roosevelt, having in his view the electoral battle to win a second mandate. In this phase, it has been recognized the influence exercised by Keynes's support to a policy of *deficit spending*, in fact already in place before, but not with the explicit mission to reduce unemployment at national level.

Other legislative and administrative decisions, which were adopted in that period, can be considered the pillars of a *Welfare State* that was not typical of the progressive culture in the United States. Three main provisions can be named as a result of this wave in the years 1935-6: the *Works Progress Administration* to employ millions of people; the *Social Security Act* to create a federal retirement pension system and the *Soil Conservation and Domestic Allotment Act* to help farmers[35]. Together with them other measures gave rise to a number of public bodies identifiable through their acronysms such as the *Federal Deposit Insurance Corporation (Fdic)*, the *Federal Crop Insurance Corporation (Fcic)*, the *Federal Housing Administration (Fha)* and so on.

3.2. The interpretations of the crisis

The chronology of events could induce an explanation of the depression based on a causal direction moving from financial variables towards real ones, but if one deals with the extensive literature, not only economic, arisen from the *Great Crash*, is bound to find a number of different interpretations of the chain of causality, as well as of the sign, positive or negative, of the impact determined by Roosevelt's interventionist policy. In fact if one accepts the idea of «Black Tuesday» (29th October 1929) as the point of departure of the crisis he must admit that, at first sight, it is not appropriate to talk of stock prices simply as financial variables, since, whatever is the profile of the market, stock prices should reflect, to some extent, the movements of the real values in the economy.

Although it could appear a simplifying approach to such literature, we think that it is possible to distinguish among the scholars, who have been dealing with the *Great Depression*, those who, moving from a free trade framework, have tried to reduce it to an unhappy episode, unable to destroy the substantial belief in the adequate functioning of market mechanisms; in this case, but not only in this case, it is possible to register also a sceptical view on the real impact of Roosevelt's *New Deal*.

On the other side, there has been different explanations put forward by the interventionist family, who, apart from producing a positive image of the *New Deal*, have singled out some elements of weakness in the normal operating of

[35] The *minimum wage* to defend the weakest workers in the market is worth reminding as part of these measures.

the American capitalism, requiring, therefore, a more or less dose of interventionism to put it on a more stable track[36].

Schumpeter can be certainly considered as an economist strongly convinced of the capacity of a capitalistic market to regain the tendency to grow, although it is characterized by an immanent cyclical path[37]. Then the eruption of such a big event as the *Great Depression* can essentially be explained through the presence of a number of exogenous events able to produce *shocks* well above the physiological ups and downs of a capitalistic system.

Schumpeter had the idea to assimilate the *Great Depression* to other cyclical experiences, in 1825 and 1873, which had been overcome without any relevant intervention from the state; of course there could be different causal factors and Schumpeter listed a number of them, divided unconvincingly in endogeneous and exogeneous[38].

The former can be traced essentially in the underlying Schumpeterian view of growth within a capitalistic system, where the erratic role of innovation is decisive in determining both the acceleration and deceleration of the economy.

Among the latter, in fact he includes some as the easiness in banking management, the diffused speculative mania, the excess in indebteness throughout the economy, which is difficult to classify simply as exogenous. It is the same for other aspects, emerging from the international contest: the agrarian crisis, the unwise assessment given to war reparations, the enlarged presence of destabilising capital movements, the growing rigidity in wages and prices.

A major emphasis is given by Schumpeter to the dimension of public expenditure in the United States, devoted to public works at all levels in the preceding expansionary phase, although his assertion is not clearly supported by evidence. At the same time, Schumpeter underestimated the effects of monetary policy in the worsening of the depression, because it has not been, in his opinion, so restrictive as it has been largely considered (see p. 9).

According to Schumpeter, therefore cycles, being connaturated to the dynamics of a capitalistic system, cannot be considered signs of illness requiring some corrections from the state; the endogenous forces of the economy are in condition to regain a positive trend after a temporary decline. A counterfactual experiment cannot be put in place, as the economists would like to do and, therefore, there is some margin to believe, on the same wave-length as Schumpeter, that a more traditional liberal approach could be adequate to overcome

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36 And to raise doubts on the main national experience of capitalism, it has meant, for many, of course, to raise doubts on capitalism itself.

37 It is useful to remember that Joseph Alois Schumpeter has given an important contribution to trade cycle theory; see, for instance, his *Business cycles. A theoretical historical and statistical analysis of the capitalist process*, 2 voll., McGraw Hill, New York, 1939.

38 The treatment of Schumpeterian view is largely based on Franzini M., *Le teorie economiche e la grande depressione*, Kappa, Roma, 1984, ch. 1.

the *great crash*, as it has happened in the other mentioned cases many decades before.

Apart from this inevitable point of view, which represents one of the main stream in the endless quarrel among economists, there is the sense of some inconsistency in the *reduction ad unum*, operated by Schumpeter, for all cycles; as we have seen before, he himself had signalled the presence of many factors of crisis, internal and external, in the 1929 case, so that his own analyisis can give some support to different explanations, as we'll see.

However, just regarding the choices done by monetary authorities, we have mentioned (see p. 9) the position expressed by Friedman and Schwartz, who not only attributed the restrictionist label to the decisions adopted by the Fed in the crucial years close to the outbreak of the «Black Tuesday», but considered that behaviour as the main determinant of the *Great Depression*. So we can remark how, in spite of the same belief in the soundness of a market economy, the causal interpretation can be deeply different: with Schumpeter, on one side, trying to outline a complex entanglement of explanatory factors and Friedman and Schwartz, from the other, trying to isolate the discretionary monetary variables as the mainly exogenous and destabilizing element[39].

It is interesting to note that Keynes himself, writing at the time[40], puts his finger against the Fed's policy, which determined a rise in the rates of interest, considered particularly unwise by Keynes. However, this point, although relevant is part of an analytical approach quite different from the one followed by the authors previously mentioned.

Actually Keynes intervened when, especially with his *Treatise*, he was still in search of a more advanced and complete macroeconomic theory, which came to light with his *General theory* in 1936 (see n. 30). At the same time he was already convinced of the structural limits of a market economy, necessarily in need to be removed by proper interventions of policy makers; being Keynes free from the idea of a deterministic state of nature governing the evolution of the economy it has been possible to write that: «Keynes's lesson leads in fact not to the listing of insoluble contradictions or the anticipation of catastrophies, but to

[39] It must be said that Friedman and Schwartz produced an impressive empirical evidence to support their position in the book already cited (see n. 27) and also that, before them, a similar point of view concerning the Fed's policy in those years had been taken by other scholars; see Currie L., *The supply and control of money in the United States*, Harvard University Press, Cambridge, 1934 and Warburton C., *Monetary theory, full production and the Great Depression*, «Econometrica» (1945). A convergent point of view was expressed afterwards in: Lundberg E., *Instability and economic growth*, Yale University Press, New Haven, 1968.

[40] First of all, see Keynes J. M., *A treatise on money,* reprinted as voll. v and vi in Moggridge D. (ed.), *The collected writings of J. M. Keynes*, MacMillan, London, 1979 (1930) ; other writings on the same topic can be found in this monumental work edited by Moggridge. On Keynes's intellectual evolution from the *Treatise* to the *General theory*, see Moggridge D., *From the Treatise to the General theory: an exercise in chronology*, «History of Political Economy», 1973.

the research of ways able to the implementation of possible social improvements»[41].

Then in the background of his critical analysis there is the deflationary bias imposed on the economy through the hasty return to the Gold Standard in the Twenties, the constraints on international capital flows deriving from the War Reparations, the creeping attempts to reduce money wages; after that, the higher monetary rates of interest produced by the Fed's caution on money supply, are bound to depress even more the *animal spirits* of the entrepreneurs emerging from what Keynes saw, reasoning along Wicksellian lines[42], as a fall in the natural rate of interest, that is the equilibrium point between saving and investment.

The emphasis given to what Keynes considered the mistakes in the monetary policy was accompanied, in fact, by an attention given to the misbehaviour also of the financial institutions and to the weaknesses of the real economy, affected by the weakening of the preceding wave of innovations and capital accumulation[43]. The picture of the *Great Depression*, outlined in Keynes's writings, represented actually a specific interpretation of that event.

It is certainly possible to include Minsky's analysis of the *Great Depression* among those starting from Keynes's idea of an intrinsic instability of capitalism; at the same time, it is also true that Minsky has carried on his work along original lines[44], which erected the financial system at the core of that instability.

It is undoubtly in line with the needs of an economy intended to grow the expansion of the financial institutions and of all kinds of assets and liabilities to face the changing requests of savers and investors; at the same time, it is easy to understand the enormous and increasing amount of decisions that people and

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[41] See Caffe' F., *L'economia keynesiana e la politica economica*, «Rassegna Economica», 1975, p. 853 (*our translation*).

[42] Wicksell was used to argue in terms of «monetary» and «natural» rate of interest. Keynes had not come yet to assert his own idea of the equilibrium between saving and investment obtained through variations in income.

[43] According to Franzini, on the other side, Keynes neglected, when dealing with the *Great Depression*, the contribution to the fall in production due to a fall in real consumption; then it can be that Keynes himself has not accurately defined the role of consumption as a more stable component of effective demand. See Franzini M., *Le teorie economiche ...*, cit., pp. 67–9.

[44] In effect Minsky has mentioned Keynes together with Simons, Clark, Hart e Fisher as the group of economists who had inspired his research. Minsky, who can be classified as a post-Keynesian economist, has devoted many works to our topic; see, among them, Minsky H. P., *The financial instability hypothesis: capitalist processes and the behavior of the economy*, in Kindleberger C. P. and Laffargue P. J. (eds.), *Financial crisis, theory, history, and policy*, Cambridge University Press, Cambridge, 1978; id. id., "*Finance and profits, the changing nature of business cycles*», The Business Cycle and Public Policy, 1929–1980, Joint Economic Committee, Congress of the United States, United States Government Printing Office, Washington D.C. 1980; reprinted in id. id., *Can «it» happen again?*, Sharpe, Armonk , 1982.

institutions operating in the financial market have to take. And these people and institutions can differ in their expectations for the future, in their attitude to risk and uncertainty, in being creditors or debtors, who can register gains and losses on capital account.

This complex network of agents should be possibly work under the market rules, the rules provided by the policymakers and the more or less accurate supervision of public institutions; all that could be, on the other side, exposed to partial crises here and there, always potentially inclined to become general or systemic. According to Minsky, in the United States, the years of prosperity in the Twenties had also seen a large increase in private debts, both of individuals and firms, which became more burdensome because of the deflationary turning-point taking place in the country.

Under these circumstances, it is possible for a liquidity crisis to occur, in the sense that many economic units were in need to reshuffle their financial situation, when a pervasive negative «wealth effect», due to the fall in share prices, was also working in a depressive sense. Of course the mechanisms through which the crisis spreads within the financial sector and, then, out of it, in the real activities must be explained and that has been Minsky's research, whatever it is the judgment on it; furthermore, it should be recalled that the implicit and explicit message, coming from his works, was in support of some effective rules preventing and correcting the wrongdoings of the financial markets[45].

Galbraith, on his side, is well-known as an economist aware of the changes that can be discovered in the institutions and functioning of the capitalistic system, which has been dominant in the last centuries[46]; he has paid particular attention to the evolution from a

Smithian-Paretian model of capitalism based on a myriad of small firms, run by very active entrepreneurs, facing a labour market of isolated workers to a model of *big business*, governed by a group of managers, on one side, and *big labour*, that is workers organized by their Trade Unions, on the other[47].

A capitalism, then, where the essential role, traditionally played by flexible market prices (wages included) in maintaining a substantial stability for the system, has been reduced by the operation of the new *big actors*, who have produced rigidities in price mechanism, giving rise to adjustments processes relying more on variations in quantities rather than in prices: a new scenario that Keynes has tried to interpret with his *General theory*.

It is not surprising, therefore, that Galbraith has written a monograph on the American experience, which has largely questioned the ability of a market,

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[45] See Caffè F., *L'eredità intellettuale keynesiana e gli odierni problemi mondiali*, in id. id., *In difesa del «welfare state»*, Rosenberg & Sellier, Torino, 1986, pp.102 ff.

[46] See Galbraith J. K., *The affluent society*, Hamilton, London, 1958 and *The new industrial state*, Hamilton, London, 1967.

[47] In *The new industrial state*, the technological factor plays a fundamental role in this expansion of the so-called «technostructures» (*ibidem,* ch. vi).

ruled by supplies and demands, to prevent a deep crisis[48]. However, when faced with the ambition to put forward his own view on the causal factors of the depression, Galbraith has considered a number of them, which have to do with the behaviour of many institutions, public and private.

This will appear going through his classification between *internal* and *external* factors, although Galbraith thought that, in the end, the *internal* factors were more important to explain what he viewed essentially as a structural break in the American capitalism of the first decade after the World War I. And in producing his list there is no surprise in remarking the presence of elements, already put into evidence by other scholars: it is the case, of course, of the alleged excess of speculation connected with a general attitude of individuals, banks and firms to take high risks. From this point of view it is possible for Galbraith to talk of: bad management of industrial and financial firms; inefficiencies in the banking system; too many speculative loans.

Moreover, Galbraith does not ignore the negative aspect of the unfair distribution of income that is typical of any capitalistic system, also in periods of prosperity when a growing national income can offer the opportunity for the increase in personal income of many people, what is, at the same time, compatible with a more unequal income distribution in any country.

This can be a social problem, of course, since it can affect the social cohesion, but it can be considered also an economic problem, because an unfair income distribution can alter the virtuous monetary circle between firms and households, with a consequent decline in real production[49].

Among those factors that he considered *internal*, Galbraith does not neglect the inadequacies of economic policy, suggested by the dominant economic culture of the time, rather cautious in terms of supply of monetary base and, on the fiscal policy side, full of respect for the idea of zero budget deficits (see 3.1).

Finally Galbraith recalls our attention on the *external* factors: one is linked to the Keynes's pioneer work, where he has challenged the economic wisdom of the Treaty on War Reparations, because of the distortions that it could create to a smooth functioning of the balance of payments between creditor and debtor countries[50]. In fact the American economy had been called to contribute systematically to the financing of France and Germany, which had deficits in their balance of payment and that structural disequilibrium had become a point of weakness in the system of international payments.

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48 See Galbraith J. K., *The great crash …*, cit.

49 As it will be seen in a moment, income distribution plays a fundamental role in the reasoning of the underconsumistic scholars. In this case, as it was in Galbraith, we are making reference to income distribution among social classes (functional income distribution); any set up in this field is obviously connected with personal income distribution, measured through some indexes such as Gini coefficient.

50 See Keynes J. M., *The economic consequences of the Peace*, Harcourt Brace, New York, 1920.

At the same time, and here is the second *external* factor according to Galbraith, the United States had not assumed the role of the leading country in that system, which was still trying to find a new assessment after the London-driven *gold standard*'s fall, because of the World War I, and the confused attempt to built a *gold-exchange standard* after the War.

Galbraith's work can be lacking of a convincing organic picture of the *Great Crash*, explaining the links among all his critical factors but, on the other side, it is rich in ideas and insights, although evasive in giving suggestions and recipes for the future.

In a larger view of what can be still regarded as problems of income distribution, it is worth mentioning the emphasis put by Lewis on the decline of agriculture, in terms of relative prices with the other sectors, during the positive years before the depression in the United States; and again on regional differentiation within the country, in the same period, following the works of Arndt, Lewis and Kindleberger[51]. Furthermore, from the same authors, there is attention at the international contest, which had shown enlarging gaps in Gdp growth among countries, creeping protectionist attitudes, tensions deriving from the lacking alternation of positive and negative positions in the balance of payments of the main countries; from this point of view, especially Kindleberger shared Galbraith's view on the missing role of an international leader, substantially abandoned by Great Britain and not taken over adequately by the United States, rather reluctant to operate as *last resort lender*.

Finally we must take into account that part of the literature, nourished by the wish to put the «big questions» on the table, which has essentially meant a discussion on the nature of capitalism. In fact, this intellectual challenge has been accepted by many scholars, which, following different approaches, have looked at capitalism as an economic system intrinsically exposed to periodical crisis of all dimensions, including the catastrophic years of the *Great Crash*. It can be said that this line of economic thought has come to a cultural and practical vindication in face of the *Great Depression*, which gave ground to less apologetic visions of capitalism.

The old roots can be found in the contribution of past economists (Malthus, Sismondi, I. A. Hobson and others)[52], who have put into evidence the existence of a realization problem, that is of conversion into cash of the whole production of firms, and also found an echo in the Keynesian tradition[53]. In their opinion, within a capitalistic economy, this is mainly due to the limited resources available to workers, who are inclined to spend more of their income on con-

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[51] See Arndt H. W., *The economic lessons of the Nineteenth Thirties*, Oxford University Press, Oxford, 1943; Lewis W. A., *Economic survey, 1919-39*, Allen & Unwin, London, 1949; Kindleberger C. P., *The world in depression, 1929-39*, University of California Press, Berkeley, 1973. On this, much is due to Ciocca P., *L'instabilità ...*, cit., pp. 176–8.

[52] See Schumpeter J. A., *History of economic analysis*, Allen & Unwin, London, 1963, pp. 738 ff. and *passim.*

[53] In Keynesian terms one could talk of lack in effective demand.

sumption goods in comparison to other classes. If there exists a way out of this chronic tendency, it can be found: in Malthus, through the presence of privileged people, enjoying unearned income as the rents for the landowners; in Hobson, through the search of market outlets abroad, introducing one of the theories of economic imperialism; in others, more linked to Keynes's message, through the active role of the state.

The assessment of the last approach to the *Great Depression*, which we want to deal with, can be more controversial; we are making reference to the followers of the «'stagnation thesis' associated particularly with the name of Alvin Hansen»[54] and combined with Keynes himself. In their case, it is private investment more than private consumption, in a logical scheme, which can be briefly expressed as: «the level of output and employment as a whole depends on the amount of investment» ... «because it is usual in a complex system to regard as the *causa causans* that factor which is most prone to sudden and wide fluctuation»[55]. Actually the flag of this thesis, departing from the Keynes-Hansen line, has been especially hoisted by a group of economists: Kalecki, Dobb, Steindl, Baran and Sweezy, among the others, influenced by Marx's stagnationist vision of capitalism[56].

It is interesting to remark that, even in the analysis worked out by them, an essential role is attributed to the activity of big firms as it has been done by Galbraith (see pp. 14–5); however, in their case, the growing oligopolistic structure, achieved by capitalism in the United States, is part of analytical models, where the «degree of monopoly»[57] is a major determinant in producing some excess capacity, a sort of malaise of modern capitalism, as it has been largely shown by the *Great Depression*.

Just keeping in mind our purpose, a difference can be noticed between the research done by Steindl[58], on one side, and by Baran and Sweezy[59], on the other: Steindl is specifically committed to propose his theoretical view of the stagnation, which affected United States' economy in the decade 1930-39, but considering a temporal interval going back for many decades. This view is based on a model of the accumulation of capital, supported by some empirical evi-

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[54] See Dobb M. , *Full employment and capitalism*, in id. id., *On economic theory and socialism. Collected papers*, Routledge and Kegan Paul, London, 1965 (1955), p. 217.

[55] See Harris S. E. (ed.), *The new economics: Keynes' influence on theory and public policy*, Dobson, London, 1960, p.191.

[56] A quick reference to this large cultural course reminds the effects of the tendency of the rate of profit to fall or of the wrong proportions among productive sectors. Ciocca's book (see n. 27) is again very useful; pp. 77–81 and pp. 178–9.

[57] This is one of the major analytical contribution to be recognized to M. Kalecki; see his *Essays in the theory of economic fluctuations*, Allen & Unwin, London, 1939 and *Theory of economic dynamics*, Unwin, London, 1965 (1954).

[58] See Steindl J., *Maturity and stagnation in the American capitalism*, Blackwell, Oxford, 1952.

[59] See Baran Paul A. and Sweezy P. M., *Monopoly capital. An essay on the American economic and social order*, Monthly Review Press, New York, 1966.

dence, which takes the presence of the *New Deal* as an event of minor relevance for the evolution of American capitalism, having his main causes in the peculiarities of its investment through time. The essence of Steindl's argument lies in the outline of an economic system, conducted by its internal dynamics to determine excess capacity.

Baran and Sweezy, on their side, have updated the stagnation thesis, emerging from previous Marxian writers, to the period after the World War II, when the capitalistic markets, to begin with that of the United States, were progressively assuming a profile far and far away from the ideal model of perfect competition. That is why, after having paid tribute to Kalecki and Steindl as their inspirers[60], they introduce a new concept, «economic surplus»[61], to be utilised for the analysis of a world dominated by the presence of large corporations.

This capitalism is able to produce a growing amount of this surplus, both in absolute quantity and as a share of national production, but the intrinsic contradiction lies in the incapacity to express, spontaneously, an equal amount of demand to absorb it. According to the two authors, apart from the efforts done by the private firms to induce demand for «unnecessary goods» from the market, the only way to solve this contradiction is public expenditure and the military one seems to be, from a political point of view, the most compatible type of it, in spite of the existence of many social needs that could be faced alternatively.

In this contest the experience of the *New Deal* comes in to their support, since Baran and Sweezy express their approval for the attempts done to increase the level of social public expenditure in those years but, as they try to give evidence, the resistance opposed by the coalition of vested interests of all kinds succeeded in keeping that level well below what was necessary[62]. Only the immanent danger of a new war was able, on the contrary, to determine a quick uprising of public expenditure for military targets, conducive to a significant drop in unemployment; and that, the authors say, went in accordance with ther view.

It has been remarked, in a review article of the book, the presence of some pessimistic determinism in this view[63]; more than that, however, it must be add that the disappointing exits, which the experience of the countries of real

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[60] «And anyone familiar with the work of Kalecki and Steindl will readily recognize that the authors of the present work owe a great deal to them». *Ibidem*, p. 56.

[61] Departing from the Marxian orthodoxy, they write: «The economic surplus, in the briefest possibile definition, is the difference between what a society produces and the costs of producing it». *Ibidem*, p. 9.

[62] «Not that we wish to call in question the welfare goals which the New Deal increases in government spending were intended to serve»; anyway: «Regarded as a salvage operation for the United States economy as a whole, the New Deal was thus a clear failure». *Ibidem*, p.160.

[63] See Caffè F., Capitalismo monopolistico, Nuovo Stato industriale *ed effettiva realtà economica*, in id. id., *Teorie e problemi di politica sociale,* Laterza, Bari, 1970; reprinted in Amari G. and Rocchi N. (eds.), *Federico Caffè. Un economista per il nostro tempo*, Ediesse, Roma, 2009.

socialism, with their planned economies, have come to, would perhaps encourage Baran and Sweezy to pursue new ways to absorb the surplus, produced by capitalistic firms rather than express their confidence in a radical overturning of the rules governing the economic system[64].

4. What we have really learnt from the 1929's Great Crash

At this moment the financial breakdown seems to have come to a halt, but here and there the signs of distress still persist, with the credit flows still insufficient to sustain a substantial recovery and many operators (banks and other financial institutions, firms, huseholds), as already mentioned (see 2), engaged in a process of «deleverage»[65].

Unfortunately some difficulties are not completely solved in the United States; in the recent publication of IMF, the authors say that the country «is grappling with the financial core of the crisis»[66]. More specifically, they say: «...policies must address the problems at the core of the financial system: the growing burden of problem assets and uncertainty about banks' solvency. Balance sheets need to be restore, both by removing bad assets and by injecting new capital in a transparent manner, so as to convince market of these institutions' return to solvency»[67].

It is worth noticing this call for policy intervention, coming from an institution that has been at the core of the *Washington Consensus* (see 1); actually this readiness to intervene, largely shared by national and international institutions, appears to mark one of the difference from the «wait and see» attitude chosen by the Hoover Administration in the first years after the *Great Crash*. In what monetary authorities of the time were concerned, we have also seen that the restrictive direction given to their tools has been thought inappropriate by some outstanding economists (see 3).

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[64] «As the world revolution spreads and the socialist countries show by their example that it is possible to use man's mastery over the forces of nature to build a rational society satisfying the human needs of human beings, more and more Americans are bound to question the necessity of what now they take for granted. And once that happens on a mass scale, the most powerful supports of the present irrational system will crumble and the problem of creating anew will impose itself as a sheer necessity». *Ibidem*, p. 367.

[65] A cautious optimism on international financial markets, including the tendential upward movements in stock markets, emerges from Draghi M., *Considerazioni finali all'Assemblea ordinaria dei partecipanti*, Banca d'Italia, Roma, 29 maggio 2009, pp. 4–5.

[66] See International Monetary Fund, *World economic outlook. Crisis and recovery*, Washington, April 2009, p. 63.

[67] *Ibidem*, p. 65.

We must underline that the relatively quick answer to 2007 crisis, came from a Republican Administration, generally prone to proclaim its adherence to the rules of a free market. It is true that also in the period dominated by the «trickle-down theory» we have seen that, for sake of pragmatism rather than for a return to Keynesianism, a series of yearly budget deficits had characterized the fiscal policy in the United States (see 1).

It seems convinging, anyway, the idea that the same pragmatism have led the Bush Administration and the Fed to rediscover instruments of an active economic policy, put aside by the neo-liberal wave, but well established both in economic history, i. e. the years of the *New Deal*, and in many text-books[68].

Under the frightnening economic scenario of mid 2008, a *cheap money* policy opened the way to consistent liquidity flows, explicitly devoted, to some extent, to the rescue or even the survival of important financial institutions (see 2). It has not been very easy, on the contrary, to propagate the effects of this expansionary monetary policy through the markets, because the channels of transmission have been temporarily obstructed by a growing differential between the declining official rate of interest and the whole structure of interest rates, including inter-bank lending and credit from banks to firms and households.

This interventionist drive has been chosen by policymakers governing many countries and international insitutions, of course with more or less instruments, depending on the specific diagnoses, traditions and constraints[69]. There have been also some attempts to coordinate this activity: on monetary policy, some Central Banks have tried a pre-emptive consultation before implementing their decision on the lowering of the rates of interest and all kind of political summits (bilateral or multilateral, such as G8 and G20) have also tried to avoid unilateral choices on exchange rates and international trade.

Evidently there has been a general concern for the repercussions of the profound financial disturbances in the United States: throughout the other sectors of the economy, there, and throughout all sectors, including the financial one, in other countries. In fact, the financial area has become in itself relevant, in terms of employment and production, almost everywhere and, moreover, it was inevitable the extension of the crisis elsewhere, in a world where the interdependence of national economies had been continuously expanding.

One can see one more difference from the world of the years of the *Great Depression* in this higher degree of internationalization; on the other side, an other difference from those years, the presence of important multilateral organizations (Imf, WB, Wto), should govern this interdependence among the national

[68] We can rightly include, among the inspiring sources, the research on the *Great Depression* due the Chairman of the Fed Bernanke, who was well aware of the risk of propagation of a crisis deriving from a «credit crunch» (see n. 21).
[69] An interesting survey of the provisions taken by many insitutions can be found in International Labour Office,*The financial and economic crisis: a decent work response*, Geneva, 2009, especially ch. 2.

economies. The organization which has tried to exercise a very positive function has been the Imf, very active in support of weak economies with new resources, initially coming from Japan, China, and Ue and, among those economies, some countries of the Commonwealth of Independent States (Armenia, Bielarus, Georgia and Ukraine) have received financial help to cover the deficits in their balance of payments[70].

These new resources have come from the last G20 Summit, held in London in April 2009, where some observers have seen a turning point in the pyramid of world power, with the weakening of the leadership of the United States in favour of a bigger say from other countries (China, Japan, Brazil, India and so on) or regional institutions, such as the European Union.

This meeting was also important because it has registered a slight cultural shift from unilateralism to multilateralism in the economic running of the world economy; this could mean that, following about three decades spent under the domain of «deregulation», we are moving towards: change in the distribution of voting powers within the main international organizations, especially Imf and WB; more attention to the problems of income distribution among and within countries; acknowledgement of an operational, and not only advisory, function to the Financial Stability Board (Fsb), placed «to address vulnerability and to develop and implement strong regulatory, supervisory and other policies in the interest of financial stability»[71].

It must be remarked, however, the change in international scenario from the *Great Crash* to nowadays, when the Fsb has to find its way within an international network, which is crowded by national, regional, multilateral institutions, and has to start from the ambiguities, perhaps inevitable, of the final document signed at G20 Summit: «We believe that the only sure foundation for sustainable globalisation and rising prosperity for all is an open world economy based on market principles, effective regulation, and strong global institutions»[72].

For the moment it is a significant signal that the agenda of the first plenary meeting of the Fbs, to be held in Basle in June, will include hedge funds and executive pay: the funds which have been under scrutiny, together with other financial institutions, as protagonist of the recent crisis; the executive pay, since there has been a large convergence of opinions on considering that aspect of income distribution as one of the main distorsions emerging from the empirical evidence on the performance of contemporary markets, characterized by the presence of big corporations.

It must be added that the technical apparatus, necessary to support a more careful action of monitoring and supervising the whole range of financial institutions, has achieved important results; the concept of financial stress, for

[70] See International Monetary Fund, *World ...*, cit., p. 84.
[71] This body results from an enlargement and reinforcement of the Financial Stability Forum, also chaired by M. Draghi (see n. 17).
[72] See http://www.londonsummit.gov.uk/en/summit-aims/summit-communique.

instance, has left the world of being a fine metaphor to become the base of «a financial stress index», through which useful empirical analyses and an «effective» regulation can be carried out[73].

On the long way to go before coming to the level of consent necessary to support the idea of a «Bretton Woods II», where the «new rules of the game» for the whole network of international economic relationships could be defined, we can register the presence of some interesting proposals. First, there is the attempt from Italy, which is the host country for the next G8 in July, to come to the definition of a «legal standard», that is a system of binding norms for the correct execution of financial and real international transactions. Second, the International Labour Office, in a recent *Report*[74], has thrown up the idea of a «Global jobs pact» because, in their opinion, «it will not be possible to reactivate the economy in a sustainable manner unless greater emphasis is placed on decent and productive employment for women and men, well-designed social protection and workers' rights».

The unquestionable sound of a compromise, which can be read behind the words «market principles, effective regulation, and strong global institutions», just mentioned, is a warning against any illusion that the crisis has paved the way for an undisputed return to an economic policy, clearly aware of the incidence of «market failures» on efficiency and equity[75]. This does not mean that all kind of interventions recently activated at national and international level could get over the risks of running into some «government failures» on the same fields[76].

Furthermore, it is certainly true that more and more research on the causes of the 2007 crisis will be carried on in the future and we can expect again, as we have seen in the case of the *Great Depression* (see 3.2), a range

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[73] See International Monetary Fund, *World...*, ch. 4 and *Global financial stability report. Responding to the financial crisis and measuring systemic risk*, Washington, 2009.

[74] See International Labour Office, *The financial...*, cit., pp. x-xi. We cannot miss the opportunity to put again on the table, very resolutely, the proposal to give the world's workers the same institutional dignity obtained, through Imf, WB and Wto, by the other economic variables operating in the international contest. On this point see Tiberi M., *Poverty...*, cit., p. 379.

[75] An interesting evidence of our worries comes from a recent issue of the prestigious British weekly «Economist». In the editorial *Government and business in America. Piling on*, May 30th 2009, we can read: «Moreover, even the most stalwart defenders of the free market, including this newspaper, admit it has shortcomings that only the government can address. The financial system requires close oversight, or crisis will destabilise it» (p. 13). And afterwards: « But in the meantime they (Mr. Obama's people) are introducing new rules, such as limits on performance-related pay at banks, that could do more harm than good» (*ivi*).

[76] A good treatment of «market» and «government failures» can be found in Acocella N., *Economic policy in the age of globalisation*, Cambridge University Press, Cambridge, 2005, chapters 2-5. We recall again the risks of increasing the level of *moral hazard* , which can be chosen by people responsible for governing financial institutions and getting used to «bailing out» interventions; see n. 17.

of interpretations, where the emphasis on the two types of failures as well as on the role played by financial and real variables will be different from scholar to scholar. On the other side, the data reproduced in the following *Table 1* show the picture of a deep recession in the world economy, particularly relevant in some areas including many developed countries, coupled with hints of a modest non-inflationary recovery in output and trade, to begin next year[77].

Table 1.

Overview of the World Economic Outlook Projections

	Year over Year						Q4 over Q4		
	2007	2008	Projections		Difference from January 2009 WEO Projections		Estimates	Projections	
			2009	2010	2009	2010	2008	2009	2010
World output	5.2	3.2	-1.3	1.9	-1.8	-1.1	0.2	-0.6	2.6
Advanced economies	2.7	0.9	-3.8	0.0	-1.8	-1.1	-1.7	-2.6	1.0
United States	2.0	1.1	-2.8	0.0	-1.2	-1.6	-0.8	-2.2	1.5
Euro area	2.7	0.9	-4.2	-0.4	-2.2	-0.6	-1.4	-3.5	0.6
Japan	2.4	-0.6	-6.2	0.5	-3.6	-0.1	-4.3	-2.7	-0.6
Emerging and developing economies	8.3	6.1	1.6	4.0	-1.7	-1.0	3.3	2.3	5.0
Africa	6.2	5.2	2.0	3.9	-1.4	-1.0	....	....	....
Central and eastern Europe	5.4	2.9	-3.7	0.8	-3.3	-1.7	....	....	....
Commonwealth of Independent States	8.6	5.5	-5.1	1.2	-4.7	-1.0	....	....	....
Developing Asia	10.6	7.7	4.8	6.1	-0.7	-0.8	....	....	....
World trade volume (goods and services)	7.2	3.3	-11.0	0.6	-8.2	-2.6	....	....	....
Imports									
Advanced economies	4.7	0.4	-12.1	0.4	-9.0	-1.5	....	....	....

[77] On the problems faced by economists in their forecasts, see Visco I., *La crisi finanziaria e le previsioni degli economisti*, Lezione svolta all'inaugurazione dell' Anno accademico 2008-9 del Master in Economia pubblica, Sapienza Università di Roma, 4 marzo 2009,
http://www.bancaditalia.it/interventi/intaltri_mdir/visco_040309/Visco_040309.pdf.

Emerging and developing economies	14.0	10.9	–8.8	0.6	-6.6	-5.2	….	….	….
Exports									
Advanced economies	6.1	1.8	-13.5	0.5	-9.8	-1.6	….	….	….
Emerging and developing economies	9.5	6.0	-6.4	1.2	-5.6	-4.2	….	….	….
Consumer prices									
Advanced economies	2.2	3.4	-0.2	0.3	-0.5	-0.5	2.1	-0.1	0.4
Emerging and developing economies	6.4	9.3	5.7	4.7	-0.1	-0.3	7.7	4.4	4.0
London interbank offered rate (percent)									
On U.S. dollar deposits	5.3	3.0	1.5	1.4	0.2	-1.5	….	….	….
On euro deposits	4.3	4.6	1.6	2.0	-0.6	-0.7	….	….	….
On Japanese yen deposits	0.9	1.0	1.0	0.5	0.0	0.1	….	….	….

There is, therefore, a good presumption that the all series of intruments, implemented by so many public institutions, are succeeding in preventing the persistence of the depression, or even worse its transformation into a deflation[78], the consequences of which could be devastating for economies full of financial debtors, to begin with the United States. Apart from that, there is enough comfort from economic history, a good team of past and contemporary economists, ethical values, to go on with a wise interventionism; it is the right time to put the neo-liberalism on the defensive[79].

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[78] Except for the raw materials, where the prices have shown, on the international markets, a remarkable volatility on both directions, it does seem that the adjustment process operates more through quantities than prices; if this rough observation were confirmed by a proper analysis, there could be enough reason to take into considerations the low competitive structures of many national markets. A clear distinct aspect of the *Great Crash*, compared to the 2007 crisis, was just a -30% deflation in the years 1930-32 for the United States.

[79] And then, there will be as for the *New Deal*, conterfactual arguments to support the idea of a better performance obtainable through a route relying on market adjustments; what can surely be done, at inverted roles, for the periods run by the rules of the free market.

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