

Times of Crisis – From a Comparative Perspective

Gabriela Marchis¹

Abstract: *Are we accursed to live in these tumultuous times that we are crossing now?* Nowadays, one of the most heard questions is: *What is the economic crisis and how it manifests itself over the years?* However, we ask about causes and consequences and most of all *when it will ends?* Economic crises are forms of disruption to economic life, due in large part to an “overproduction”. The term “overproduction” does not refer here to an output exceeding the society needs, but the situation when these needs remain uncovered, and the demand drops due to lack of funds. This major financial crisis affected the economy of all countries in all its segments: industry, agriculture, construction, trade, transport and etcetera, due to the close links between countries, as a natural consequence of globalization. Thus the current financial and economic crisis has affected industries on which the entire world economy relies on. But, from an economic perspective, the crisis is not a surprise, knowing that the economic cycles are repeated. This paper tries to identify the similarities with the previous economic downturns as a necessity to learn from the lessons of the past.

Keywords: economic cycles; economic downturn; Great Depression; European Union; financial panic.

JEL Classification: G01; F01; N10.

1 Introduction

The discussion in this paper is based on the idea that the economic crisis was no surprise, because from the economic perspective, fluctuations in economic activity is something normal and the stages of an economic cycle are very well known: crisis, depression, revival and boom.

Based on theoretical consideration I believe that the current economic crisis was predictable, knowing that the economic cycles are repeated. The whole world is currently at the end of a cycle of 70-80 years, with dramatic increases in all areas, a world where speculative economy is overrated, a world that consumes more than produces, in which the loans without coverage recently was in bloom.

¹ Senior Lecturer, PhD, Danubius University of Galati, Faculty of Economic Sciences, Romania, Address: 3 Galati Blvd, Galati, Romania, tel: +40372 361 102, fax: +40372 361 290, Corresponding author: gabrielamarchis@univ-danubius.ro

In an attempt to understand the coherent nature of the economic crisis, I reach to three simple conclusions:

- current crisis is not in a discordant note to other “accidents” in the course of economic cycle;
- each time for the Marxist tradition, cyclic recurrence economy is postulated as the “Achilles heel” of capitalism;
- economic theories inspired by the Great Depression of the 1930s, which were recently rejected from a healthy logic of economics, are now revived by appealing to an extreme interventionism and regulation of banking financial environment.

I tried through this study to clarify the causes, consequences and responses on the current worldwide economic depression by looking into the past. Also, the aim of this research is to provide a blueprint of reality and of the current economic conjuncture.

2 The Crisis – Theoretical Concepts

The term *crisis* comes from the noun Greek *krisis* which means choice, decision, and judgement.

The word *crisis* first appeared in legal, rhetorical and medical terminology as a turning point in a decision, an argument, or a disease.

In the eighteenth century it appears to refer to processes, historical periods or events, and by the last half of the twentieth century it stands and spreads as a term for a crucial stage or a decisive condition of business.

The National Bureau of Economic Research defines *crisis* as “a significant decline in economic activity spread across the economy, lasting several months, which can be seen in GDP, real income, employment, industrial production and other indicators”.

The *economic crisis* is ultimately a state of difficulty, a dramatic change in economic activities, a serious moment for the whole economy, characterized by stagnation or decline in macroeconomic performance.

“An economic crisis is an unexpected phenomenon with strong consequences for nations, institutions and people's wealth, habits, and behaviors. It departs from the ‘normal’ evolution of the affairs foreseen by economic theory. It makes the claim for new theoretical explanations. It surprises the economic agents (individuals, firms and governments) that try to ascertain what kind of phenomenon they are facing in order to decide the appropriate actions to undertake. It calls for revisions of theory, plans and expectations. Overall, a crisis calls for an explanation which

clarifies its causes." (Crespo, 2009) The emergence of alarming economic imbalances between supply and demand and between production and consumption is usually triggered by a *financial crisis*.

The *financial crisis* is a situation where demand exceeds supply of cash money, so that liquidity is quickly evaporated because available money is withdrawn from the banks, which are forced either to sell other investments to reduce the deficit, or go bankrupt.

These definitions confirm that an unexpected economic crisis is a phenomenon that has strong negative consequences on nations and institutions but also on the customs and people's welfare.

3 Important Crisis with Global Effects – A Brief Overview

Latest economic evolution indicates that the current crisis is the deepest global slowdown in economy after the Great Depression of the 1930s, marking the return of macroeconomic fluctuations of a magnitude unprecedented from the interwar period.

In terms of initial conditions and geographical origin of the crisis, there are clear similarities between the crises of 1907-1908, 1929-1933 and 2007-2011.

All occurred after a sustained boom, characterized by monetary and credit expansion, the rise of assets price and very high risk-taking of investors.

All were triggered in the first stage of events in the U.S., although the causes and imbalances that rise thereto were more complex and global, all spreading internationally to profoundly affect the world economy.

Viewed from another perspective, the lack of money in financial sectors with great worldwide repercussions, together with a sudden reduction in world trade were the main channels of transmission in the real economy.

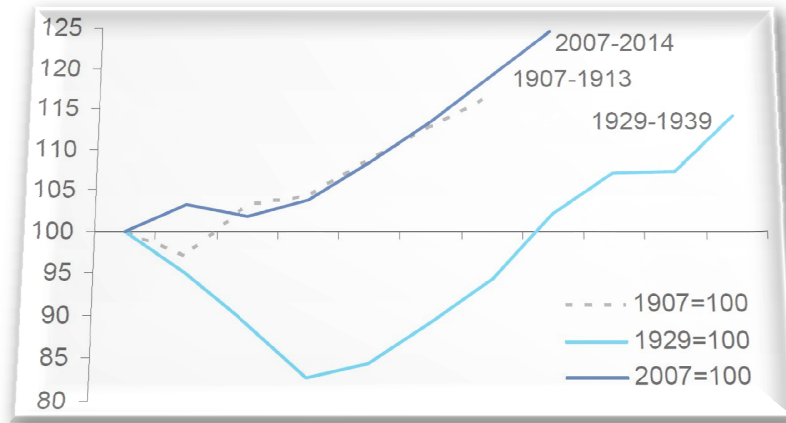


Figure 1. GDP levels during three global crises

Source: (European Commission, 2009, p. 15)

3.1 The Financial Panic of 1907-1908

Financial panic of 1907 is similar to the recent crisis – although some European countries have largely managed to avoid financial difficulties at that time – the accumulation of credits and asset price growth in the period before the crisis, stimulated by the insufficiently supervision of financial sector, and by the role of liquidity gap at the height of panic.

Also in 1907, countries were closely linked through trade and international finance, being in the glory days of the classical gold standard, in the first period of globalization, so U.S. financial markets events were quickly transmitted to other economies.

World trade and capital flows have been affected, and the world economy entered a very deep recession but for a relatively short period, followed by a strong recovery.

Balance in the economy was restored by the intervention of JP Morgan & Co. and U.S. Treasury which provided the necessary liquidity in the banking system.

3.2 Great Depression: 1929-1933

Great Depression was the largest global economic collapse so far. In the period preceding the crisis of the 1930s, most of the features presented at the one of 1907 have been met, but there were also notably differences, especially in the lower degree of financial and trade integration which were in the early stages. By the end of 1920s, the global economy has failed to overcome huge disruptions in financial

and commercial ties, arised from World War I, even if productivity and structural changes have had a strong impulse from technological developments.

The size of international capital flows and global economic integration level decreased greatly. Gradual return to the gold standard after World War I was not enough to restore financial order functionality and credibility to the prior conditions of 1914. An important source of international financial tensions were the controversies related to German redress payments established by the Treaty of Versailles. Due to the large number of bank failures in U.S. and Europe and to the inappropriate political reactions, the recession has dramatically deepened in the early 1930s.

“Increasing protectionism and the asymmetric exchange rate adjustments devastated international trade and capital flows”. (European Commission, 2009).

With so many ways of transmission, the 1929 crisis, initially emerged in the U.S. and rapidly turned into a worldwide depression, with several consecutive years of losses in GDP (see Figure 1) and industrial production (see Figura 2), and fragile recovery not until 1933.

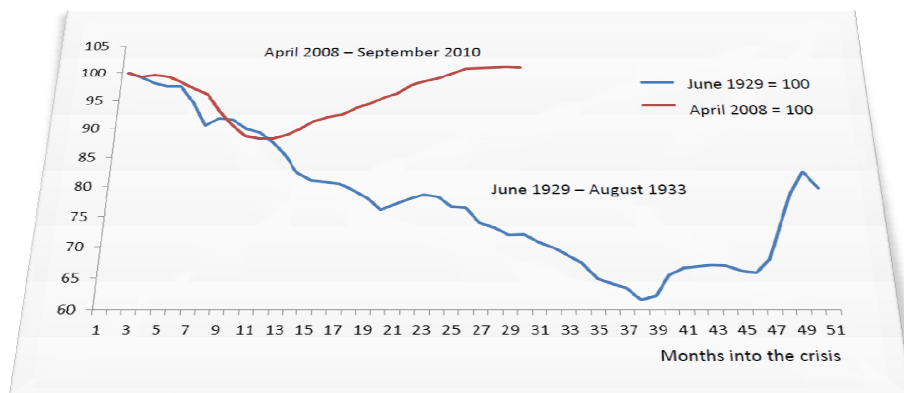


Figure 2. World industrial outputs during the Great Depression and the current crisis

Source: Adapted from (European Commission, 2009, p. 16)

Based on these indicators, the negative impact of the Great Depression seems to be more severe and on a greater time period to the current crisis.

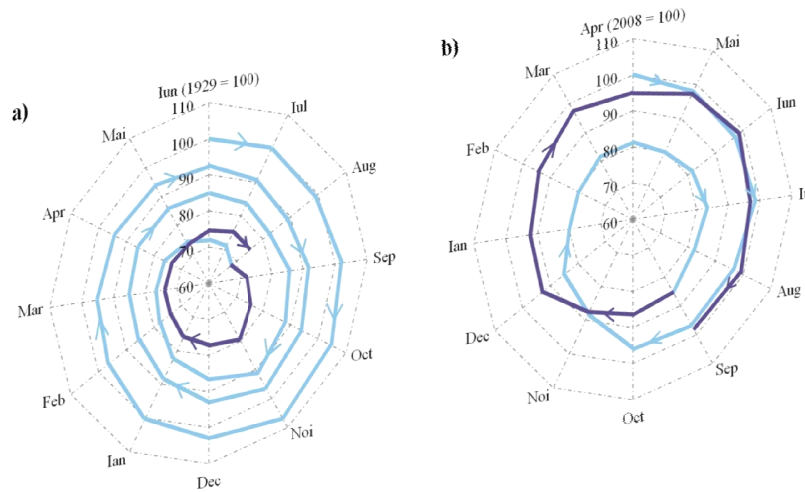


Figure 3. The decline in world trade during Great Depression (Jun. 1929-Aug. 1933) and the current crisis (Apr. 2008-Sep. 2010)

Source: Adapted from (European Commission, 2009, p. 16)

As shown in Figure 3, the reduction of world trade is more acute now than in the early 1930s. This can be explained both by the shock size and also by the faster contagion in supply chains. However, despite the initial fall, more acute in 2008-2009, the stabilization and improvement of trade seems to be faster in this crisis than in the past century.

While in the Great Depression, both developed countries and the marginal world economy were affected to a similar degree of magnitude, in the current crisis, emerging economies, whose growth was highly dependent on foreign capital flows, seem to suffer the greatest impact in the real economy, and not the countries where the crisis descended.

Another major difference is that in the 1930 there were strong and repeated decreases in the overall level of prices, causing a strong deflationary impulse spread by intended restrictive policies.

Finally, in the Great Depression there was mass unemployment, both in the U.S., where the unemployment rate approached 38% in 1933 and in Europe, where it reached even 43% in Germany and over 30% in other countries.

According to European Commission (2009), in terms of financial stress and severity fall in world trade, asset prices and economic activity, the current crisis developed faster than the Great Depression.

Also, scientific literature shows that the Great Depression offers important lessons for the current economic crisis. „*Both downturns featured global banking crises which were generated by boom–slump macroeconomic cycles. During both crises, world trade collapsed faster than world incomes and the trade decline was highly synchronized across countries. During the Depression income losses and rises in trade barriers explain trade’s collapse. Owing to vertical specialization and more intense trade in durables, today’s trade collapse is due to uncertainty and small shocks to trade costs hitting international supply chains. So far, the global economy has avoided the global trade wars and banking collapses of the Depression, perhaps owing to improved policy. Even so, the global economy remains susceptible to large shocks owing to financial innovation and technological change, as recent events illustrate.*” (Grossman & Meissner, 2010)

3.3 Current economic and financial disaster: 2007-?

Experts in economics and finance, economic commentators and everyone believe that the current financial and economic crisis is in fact the result of “greed” and “wild capitalism”. Practical reality is that this crisis is only the natural consequence of a long series of interventionist policies. These policies have done nothing over time than to undermine the market economy. The beginning of the end was started in early 2007 when the U.S. housing market started to show signs of weakness. Nowadays, this scenario is well known in Europe, as well. It may be considered that triggering economic disaster in the United States was based on the following specific reasons: state insolvency bond packages; the failure of monetary stability measures; centralized monetary planning; encouraging the subprime lending by state (mortgage loans granted by banks without taking into account the creditworthiness).

Fundamental determinant of the crisis is the inflationary policy of the early 2000s, manifested by an extremely serious “monetary relaxation”. Credit boom in developing economies in Eastern Europe has the origin into the permissive monetary policy of Federal Reserve System (FED), Bank of Japan (BoJ) and European Central Bank (ECB) in the early 2000s. For example, by 2006 the real interest rate in Euro Zone and Japan was at a level close to zero, and in U.S. real interest rate was negative between 2000-2002, which means that the banks were paid to take money from the FED, money which in the economy have been spend in accordance with others incentives and political constraints that influence decisions process.

It can be said with any certainty that the cause of the most important European economic crisis is current account deficits of countries. In most situations encountered, these deficits were fueled by a boom in housing market and huge increases in consumer spending, along with a significant decrease in savings. In

other circumstances, it was government deficits or even more loans in excess, or rather, the increasing debts of the population and businesses.

A normal question that arises is: **Which way forward?** *“The movement toward new economic global governance is not the result of a single strategy but, rather, an original blend of different solutions enhanced by flexibility and experimentalism. Some of these solutions involve efforts to strengthen multilateral agreements and the effectiveness of supranational institutions and regulatory measures; others aim to develop new forms of cooperation among governments, through a “concerted practice” form of action.”* (Napolitano, 2011)

4 Conclusions

The expansionary policy in the monetary area continues, the more serious bad investments will be, more painful will be to return back on the path of healthy growth. Therefore, the solution of the crisis really can not stand in the “money circulation” supplement, since this is a serious confusion between countercyclical and procyclical policies. This is why, we must understand that, slowing or even stopping cheap money policy are steps towards recovery.

The phenomenon of economic recession manifested itself differently in EU countries due to the diversity of these countries, in terms of economic power, pattern and level of development, culture, economic development branches. It may be observed that all EU countries and more, countries from across Europe, have seen a sudden reversal of capital flows, as investors retreated from risky markets and turned to safer savings. The results of investors’ reactions were predictable and at the same time brutal for European Union emerging economies. For example, Hungary, Romania and Latvia have appeal to substantial loans from the International Monetary Fund, all three Baltic countries were confronted with rising unemployment, Latvia, which can be said to have been hardest hit, has been confronted with the fall of the government and with the rating downgrade.

These countries fall into the classic pattern of the evolution of emerging economies, which soar to heights increase alongside with the influx of foreign capital and after that collapse, when investors prefer to withdraw from these markets and this is the boiling point because these countries become very sensitive to macroeconomic changes.

It is important to mention that, in this macroeconomic context European decision makers from the highest level have hesitated to adopt a bold policy of economic stimulation. European countries who could afford an ambitious economic stimulus program and were well correlated with the movement of markets at the macroeconomic level (as was the case of Germany) initially disapproved the economic rescue measures taken at EU level, and, on the other side, countries that

had most need it (Spain, Portugal, Italy and Greece) lacked the necessary money, these countries being already affected by huge budget deficits and massive debt, compared with their size and economic capacity.

So, I must conclude that time is very important in taking a decision and it may be essential for the success of actions and it can distinguish between success and failure.

Lack of strong and consistent decisions made that global economy contracted at a rate that is comparable, in magnitude and depth, with the collapse of 1929 and 1931 that marked the beginning of the Great Depression. By comparison, we can ask, if we are on the verge of a profound crisis for the Euro and for the European Union's existence?

The response of the Euro Area and EU as a whole, we witness in the near future, but, transposing this crisis in the European context, in terms of the particularities occurred on European economy, makes us wonder: *Are we accursed to live in these tumultuous times that we are crossing now?*

5. References

- Board of Governors of the Federal Reserve System.* (n.d.). Retrieved from www.federalreserve.gov.
- Crespo, R. F. (2009). Thinking about the financial and economic crisis: some brief notes on its causes and remedies. *Think*, 97-103.
- European Central Bank.* (n.d.). Retrieved from www.ecb.int.
- European Commission. (2009). *Economic crisis in Europe: causes, consequences and responses*. Luxembourg: Office for Official Publications of the European Communities.
- Grossman, R. S., & Meissner, C. M. (2010). International aspects of the Great Depression and the crisis of 2007: similarities, differences, and lessons. *Oxford Review Economic Policy*, 26(3), 318-338.
- Krugman, P. (2008). *The return of depression economics and the crisis of 2008*. New York: W.W. Norton & Company Inc.
- Napolitano, G. (2011). The two ways of global governance after the financial crisis: Multilateralism versus cooperation among governments. *International Journal Constitutional Law*, 9(2), 310-339.
- The National Bureau of Economic Research.* (n.d.). Retrieved from www.nber.org
- Vira, A., Philippon, T., Richardson, M., & Roubini, N. (2009). The Financial Crisis of 2007-2009: Causes and Remedies. *Financial Markets, Institutions & Instruments*, 18(2), 89-137.