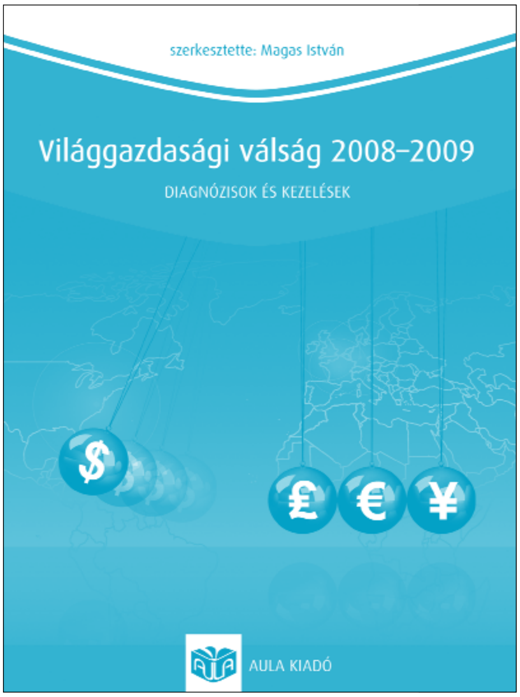
Before and After the Crisis

István Magas (editor)

World Economic Crisis (2008-2009)

Diagnoses and Treatments



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We could not see the end of the world economic crisis at the end of 2009, or even at the beginning of 2011. However, there is no reason why we should not study it with a scientific approach, trying to describe the events as best as we can and give some guidance for managing the existing problems. *The World Economic Crisis 2008–2009 (Diagnoses and Treatments)* volume, published by Budapest Corvinus University and AULA Publishers makes an attempt to do just that.

The editor has summarised the modest scientific objectives of the thick book as follows: '*The purpose of this book, as indicated by the subtitle »Diagnoses and treatments« is to present, despite the relatively few available historical data, the roots of the world economic crisis, the movements that triggered its rapid global spread and the mechanisms of the world economy, with which the negative processes spread at such a fast rate that has never been experienced before. We shall present crisis management actions (attempts) in the most important regions of the developed and developing world. We cannot report on the results or long-term effectiveness of the treatments, and we can only project the potential recovery. We do not have any extensive or reliable crisis management experience. A scientific analysis is more credible if it is aware of its own limitations.*'

This book is a collection of the results of recent research activities conducted by the members of staff, tutors and PhD students of Budapest Corvinus University World Economy Department, St. Stephen University Institute of International Economics and the Hungarian Academy of Sciences World Economy Research Institute, and brings its readers from general theoretical indicative considerations to rather specific crisis situations in the most important regions of the world economy. The book offers a wide scale of theories, status analyses and crisis management attempts, and its most important merit is large sampling and relatively fast processing. The book reflects the expected researcher honesty, and reveals uncertainties as it does not even attempt to offer guaranteed recipes. Instead, it describes crisis management attempts in the most important countries and regions of the world economy. This prudence is justified especially looking back to the previous two years.

The book consists of three main parts. The first part is *World Economic Crisis – Theoretical Concepts,* and contains six studies. The second part presents crisis management in the centre, in developed industrial countries in general and primarily in the US, as well as in the European Union through also six studies. In the third part, the authors analyse the crisis management measures of the peripheral areas in five studies.

■ The first study is entitled *'A Few Comments on the Interpretation of a Crisis and its Management',* and was written by *Tamás Szentes,* member of the Academy, professor emeritus of Budapest Corvinus University World Economy Department. In his paper, he highlights the importance of a historic approach and holistic theory, indicating that the economist approach, i.e. the analysis of only the economic causes and the manifestation of certain phenomena has been overexaggerated in the current economic literature. However, the author goes beyond the criticism of mainstream economics and declares that *'n reality not only the world economy but also the economic development so far, and in fact the total human society and its increasingly distorted culture, lifestyle, attitude, conduct and moral are all in crisis.'* In the end, Szentes concludes that there is a need for the extensive reform of the existing world order and the development of a new world order both in economy and in worldwide plural democracy. The author admits that these concepts may seem to be utopian, but Szentes believes that the impact of global crises can force such a world order, or at least collective steps towards it.

■ The second paper, written by *György Csáki,* university professor of St. Stephen University Institute of International Economics, is entitled *'World Economic Crisis and Change of an Era'.* In the introduction of his study, the author distinguishes four global crises: 1929–33, 1974–76, 1979–82 and 2007–2008. In his opinion, the recent crisis is comparable only to the 1929–33 crisis because, similarly to the period of 1929–33, in the recent crisis also *'a financial crisis stemming from the most developed country of the world triggered a worldwide financial crisis and then led to severe global recession'.*

Csáki identifies the unfortunate combination of deregulation and low interest rates as one of the direct causes of the crisis. According to the author, the crisis stemmed from the interest rate cuts and the supply of liquidity into the economy by the FED in order to give it a boost, but as the level of capital investments was too high, the additional funds could not be used for productive investment projects. In the end, this led to wasteful investments on the real estate market, and a growing bubble, which later burst. Csáki deems this crisis not only a failure of the economic policy of the Unites States, but also claims that *'neo-liberal theory and neo-conservative political ideas, which had dominated the previous three decades, collapsed in this crisis'.*

After the assessment of the precedents, Csáki moves on to the consideration of the potential consequences. According to the author, a new era began in the world economy, of which we know two things for certain: the power conditions have changed, and the future of the world economy is determined by these changed power conditions and a complex reform of the international monetary and financial system can no longer be postponed. Csáki believes that among the new power conditions the previous system based on the economic dominance and excessive power of the US is over and China has become the main actor of the world economy.

The study also concludes that the crisis fundamentally appreciated the G-20 and G-7 countries as well as the IMF. According to Csáki, such governmental cooperation will play a more important role in the near future than before. However, in his opinion the G-20 is based on the cooperation of too many countries in order to be efficient, while several important countries are missing from the G-7, yet they will have a key role in the world economic processes of the near future. The author expects a new *Gx* to emerge, where the x is somewhere between 7 and 20, and its members will include emerging countries like Brazil, India and China.

The author thinks that the role of the IMF has been appreciated because the organisation gave fast and complex responses to the crisis. Under the pressure of the crisis, the IMF quickly and significantly transformed and modernised its lending practice, which enabled it to play an important role in the supply of funds for crisis management.

Csáki closes his study with the following thoughts: *'It is obvious that the crisis, or more specifically, the severe recession will end sooner or later, but recovery is not expected to be either easy or too dynamic. The dynamism and durability of recovery depends on how fast and efficiently the (world) economy finds the forms of cooperation and mechanisms required for a global equilibrium and the power conditions of the new world economy and the new era of the world economy.'*

■ The study *Special complexity in international market processes,* contained in the book, was written by the editor, *István Magas,* university professor, head of BCU World Economy Department. In his paper, he refers to the reflexivity theory elaborated by *György Soros* earlier, and looks at the systemic lessons of the crisis primarily from the regulator's standpoint. Self-corrective behaviour, which covers the essence of reflexivity, means that the subjects of economic interactions react to the market outcomes, and react again to any new situation resulting from mass reactions, and therefore the cause and effect get mixed up in practice. The honesty, applied by the author, in his confrontation with the idea that although the economic models using intensive mathematics have been spreading for many years, the science of economics is still far away from capturing reality is definitely an additional value of the paper. It should be noted the author is perhaps too pessimistic concerning this topic, namely the relative difficulty to understand modern social and economic processes. There are continuous experiments to model complex systems also in natural sciences. Even so, attempts to model the weather on earth based on numerous physical and chemical laws led indirectly to the birth of chaos theory. The apparently accidental phenomena, which still show some regularity, the systems sensitive to initial conditions, the world of broken dimensions and fractions can be found both in social sciences and natural sciences on the current borderline of the human perceptive ability through the fascinating mixture of bifurcation. To use the terminology of finance: the 'if' lines run from crisis to crisis among the potential worlds. The author suggests something similar since he writes: *'instead of perfect points of equilibrium, we witness series of adjustment steps on the so-called markets, where the steps and the actors mutually affect each other'.* István Magas concludes that although the electronically integrated capital and money markets partly perform with the requirement of such pricing, they do not satisfy the desirable fund and asset allocation requirement. The author recommends better considered system level regulation to the international financial markets, and admits that increased security, which could then be achieved, does not come heap. However, given the risk of uncertainty, regulation is needed even on the most advanced markets, because if it is flexible and progressive, then the operation of the whole system can benefit from it. Another reason why this topic is relevant these days is that the European Parliament adopted a Directive on the Regulation of Alternative Investment Funds (AIFM Directive) in November 2010, the review and impact analysis of which could even be the topic of a subsequent research of the author, who is considered an expert in this field.

■ Understanding the processes of the internal financial markets of the American economy is fundamentally important in relation to the crisis. It is in this context that the study entitled *'Impacts of US interest rate decisions on the 2007–2008 financial crisis',* written by *Gábor Kutasi,* assistant professor of Budapest Corvinus University World Economy Department, becomes especially remarkable. Kutasi analyses the financial crisis that hit the USA from the perspective of interest policy because the FED indicative interest rate fell to the 0–0.25 percent bracket since 15 December 2008. The article makes a comparison with the period that followed a similar interest rate decision made by Japan in 2001 and analyses *'on the one hand how interest rate policies reached a point where they lost their room for manoeuvre and, on the other hand, whether or not a financial and economic crisis can be managed with a practically zero interest rate'.*

The author compares the 1989–2002 Japanese financial crisis to the 2007–2008 US crisis and concludes that they had several similar features. Fundamental errors and overheatedness, which finally led to a real estate market bubble, characterised both the Japanese and the American crises. The burst of the bubble was followed by the zero interest rate paradox, resulting from the delays of the monetary policy (sufficient liquidity was not supplied to the markets even despite the close to zero interest rate, i.e. even this interest rate could not stimulate consumption enough). The factors just referred to resulted in a so-called deflation spiral. In this spiral, orders decreased because of falling consumption, therefore companies were forced to cut their expenses and lay off employees. They also had to reduce their prices to boost demand. In a redundancy wave, people increase their savings because they do not feel safe. This makes consumption shrink even more, and the whole process spirals along.

The process described above took place in the Japanese financial crisis, which lasted for more than one decade because political decision-makers postponed the implementation of the required reforms. According to Kutasi, the United States will also need to take similar actions as Japan in order to recover from the crisis. The author thinks that these processes have already begun on the US market.

Kutasi also concludes that once monetary policy became ineffective, there were no other means left than budget intervention. Therefore, the economy stimulating plans of 2009–2010 follow the guidelines of the Keynesian economic policy as if they were taken from a textbook. However, this involves risks because the US budgetary policy of the last eight years weakened public finances so much that any crisis management with fiscal instruments could significantly increase the country risk.

The author also analyses the liquidity risks, pumped up during crisis management. In this respect, he admits that the purpose of these actions was to offset deflation trends, but the question is what will happen to the hundreds of billions of USD, issued within the framework of the bank bailout package. According to Kutasi, the extraction will take place in the form of an interest rate increase, which may further enhance the risks of interest rate volatility.

Kutasi closes his study by analysing the possibilities of world monetary governance. He reviews the discussions on the reconsideration of the authorisation of international financial institutions and the enhancement of their scope of competence as a result of the financial crisis. According to the author, it would be too early to establish a global monetary authority, but the regional/national supervisory authorities are likely to gain strength after the crisis.

■ The study entitled *'The present world economic crisis and attempts for its management'*, contained in the book was written by *Tibor Palánkai,* professor Emeritus of Budapest Corvinus University World Economy Department and *Sándor Gyula Nagy*, assistant professor of the department. Analysing the causes of the crisis, the authors reach a similar conclusion as the previous studies, and define as a starting point that the current phenomena may be called a global debt crisis. In their opinion, lending is the driving force of the economy as long as the loans are not used to finance bad investment decisions, a typical example of which is the resulting real estate bubble.

Institutional regulatory and control inadequacies and disorders are important factors also for the authors of this study. Palánkai and Nagy think that money markets were interconnected globally based on the new information and communication technologies and this extensive liberalisation and deregulation led to its sudden integration *'However, this integration was primarily »negative integration« (overall opening according to Tinbergen's interpretation), and it lacked »positive integration«, i.e. institution building and regulation)'*, conclude the authors. Thus, in their opinion, this positive integration must take place, among other things, during crisis management.

Next, the authors review the new forms of interpretation of the crisis and the understanding thereof, as well as the difficulties of a status assessment leading to appropriate action. In their opinion, the complexity and lack of transparency of the processes make it more difficult to adopt the right decisions. The statistical offices of large international institutions were unable to provide satisfactory information, therefore these institutions *'failed spectacularly in their information and analytical functions'.* The authors think that information and statistical data must be collected and the current accounting techniques and regulations need to be reviewed in relation to the new processes and developments.

In their analysis of crisis management, the authors focused on the role of the banks and their bailout packages since it was the banks that the financial crisis affected the most. Analysing the various bank bailout packages, they draw this quite important, although in its form slightly concise conclusion that *'nationalisation of banks is no longer a taboo'.*

Then, they move on to reviewing economy stimulating packages. The authors recognise the need for such a package, yet also point out important risks associated with them. On the one hand, it is essential that the measures introduced on the basis of the principles of the Keynesian economic policy carry the risk of future inflation. On the other hand, the authors also indicate that as generally economic stimulating packages are funded from government resources, they typically include some conditions for using this support within the country. However, the authors point out that, based on the experiences of the 1929–33 crisis, that this may disrupt the worldwide trade and may even cause its collapse, which would deepen the crisis and would make recovery more difficult.

In the last section of their study, the authors describe the Hungarian options of crisis management. They assert that Keynesian economic policy, applied in the West, cannot be implemented in the Hungarian macro economic situation. In their opinion, the only option is to accelerate the payments of the somewhat held-back NHDP (New Hungary Development Plan) approved for the period of 2007–2013, and to restructure accordingly the projects eligible for support in line with the objectives of crisis management.

■ The study *'Expansive fiscal policy and its impacts in the EU'* was written by *István Benczes*, assistant professor of Budapesti Corvinus University World Economy Department. The author opens the study with a general theoretical overview and then tries to reach a conclusion for the main and general features of successful budgetary stimulation based on the expansive fiscal practices of the old EU Member States (EU-15 with the exception of Luxembourg) between 1980 and 2005. In his analysis, he looks at the so-called cyclically adjusted primary balance of the relevant countries calculated without the interest service obligations and the impacts of the business cycles. In 35 of the analysed 364 cases (14 countries, 26 years), the author found that the given country conducted an expansive fiscal policy. Out of the 35 cases, 18 were successful and 17 were unsuccessful.

Then the author continues his analysis based on the 35 relevant cases. He tries to prove the assumption that the significance of the so-called *non-Keynesian* impacts is much greater than it is traditionally assumed by the sector: *'owing to the multiplicator effect, the cuts and increases of government expenditures can better improve the output level than tax reduction (the traditional Keynesian argument) or that, contrary to the former option, a lower tax burden increases economic activity'*. Therefore, in the remaining 35 cases, he continues to analyse fiscal expansion in revenue, expenditure and mixed categories.

Although later the author also notes during the review of the role of monetary authorities that *'it is one of the standard textbook theses that the reaction of monetary policy is decisive in terms of the success of the fiscal policy'*. However, his analysis of the EU countries showed that the reaction of the monetary policy was not a decisive factor for the success of fiscal expansion.

After the review of past data, Benczes tries to identify which of the previous conclusions can be generalised and the circumstances and conditions based on which successful fiscal expansion can be achieved during a crisis. According to the author, the conclusions drawn from the results of the examined period cannot be generalised since different conditions prevailed during the crisis and the positive issuance gap question whether or not fiscal expansion could have any positive impact on the economy in a way as established during the analysis. Despite this, Benczes claims that intervention is still justified because of the crisis in order to keep production capacities and jobs alive, which are likely to be viable under ordinary circumstances.

In the conclusion of his study, Benczes draws the following consequences which, in his opinion, must be taken into account for any successful budgetary expansion during crisis management. *'(1) Crisis management cannot lead to any situation similar to the prisoner's dilemma, where the benefit of one party is the loss of the others. Concerted action is required, in which protectionism cannot be a component, as in the case of the EU, it would impose a risk also on integration. (2) Not all countries can apply budgetary stimulation without any limitation. The room for manoeuvre of budgetary policy may differ significantly in different countries (...) (3) A declaration is required stating that any additional expenditure is only temporary and that after the crisis the objective will be sustainability again.'*

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The six studies, presented briefly, provide only a glimpse into the field covered by this book, which offers reading about the correlation of the Chinese economy and the crisis (written by Zsolt Szabó), the lessons of the crisis for Eastern and Central Europe 'from the inside', through the eyes of an independent observer (Judit Kozenkow and Paul Marer), and the impacts of the crisis in a distant periphery, Black Africa (study written by Balázs Szent-Iványi and András Tétényi).

Following the editor's own guidelines, we recommend this book, containing ambitious studies of reputable authors, primarily to professionals, '*who are familiar with the generally applied basic economic (world economic) categories and basic terminology. However, this book could also be very useful for bachelor and masters college and university students, who have already studies introductory economics and have some knowledge in international economics*', as the same promise is also included in the editor's own recommendation. In addition, any ordinary reader is also invited to read this book providing that they are interested in the discussions criticising the system in relation to the worldwide crisis within a wide range of social studies, the future of worldwide capitalism, the international system and the processes of the crisis. The literature on the crisis has also expanded fast, and has also been updated. This book also reflects this 'updating', and therefore it is clearly recommended to those who wish to have a slightly further outlook for the future of the world economy, to go beyond the US money market crisis and to understand the various long-term options, often independently of the fact whether a particular country is located in the centre or the periphery. The world economy is becoming an increasingly integrated system, in which we often cry and laugh together even despite our wish. The book definitely conveys this message.

Another encouragement for reading this book could be the fact that it contains self-contained studies, which can be read in any order.

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