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FROM A MODEL OF GROWTH TO A GLOBAL CRISIS

“The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes.“

John Maynard Keynes

“The old saying is absolutely right:
it is difficult to fight two enemies, especially when they are fundamentally different.“

Plato, “Laws“

“Social reforms are never carried out by the weakness of the strong;
but always by the strength of the weak.“

Karl Marx

The paper analyses the unprecedented coordinated actions to suppress the "free fall" of the United States and world economy. It then shows the role of monetary and fiscal policy of governments. The article reveals are the fundamental similarities and differences between the Great Depression of the 30-ies of the last century and the current Great Recession. It indicates the controversial results of the policies in the United States and the European Union and the emerging trend towards deflation.

JEL: F01; F63; O11; O23

In conditions when the bourgeois relations of production reach a degree of maturity, economic crises and cycles are an indispensable attribute of capitalist development. This applies to medium term fluctuations characterized by regular periodic alternation of cyclical phases (crisis, stagnation, recovery, boom).[1] Their genesis dates back to the 20-ies of the XIX century, when in England – the most developed bourgeois nation at the time, the world's first general crisis of overproduction[2] broke out. Since then many periodic cyclical crises have been observed.[3]

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[1] During the early stages of capitalism cycles are identified by the term „trade cycles“. Later in economic literature the American term „business cycles“ is affirmed.

[2] It is defined as „the first global financial crisis“ (Roubini, 2010, p. 7). This crisis has demonstrated the bankruptcy of the so-called markets law, formulated by the liberal French economist Jean-Baptiste Say in his "Treatise on Political Economy". The "discovery" of Say supposed the impossibility of general crises of overproduction of goods and allowed only the possibility of partial sector crises.

[3] Even Friedrich Engels pays attention to the periodical nature of cyclic crises.. He writes: “… since 1825, when the first general crisis broke out, the whole industrial and commercial world, production and exchange among all civilised peoples and their more or less barbaric hangers-on, are thrown out of joint about once every ten years“ (Engels, 1954, p. 304). Indicating the manifestations of crisis and stagnation, Engels notes that after them comes a movement in an upward direction – to recovery and boom of production, after which inevitably comes another crisis. „Little by little the pace quickens (towards recovery – author’s note), it becomes a trot, the industrial trot breaks into a canter, the canter in turn grows into the headlong gallop of a perfect steeplechase of industry, commercial credit, and speculation, which finally, after break-neck leaps, ends where it began - in the ditch of a crisis. And so over and over again“ (ibid.).

Object of the study is the current global crisis with its processes occurring in the financial and economic sphere, mainly in the United States and European Union (EU).[4] It is not only economic and financial but also a political, social, ideological and moral crisis of modern capitalism; of the values of bourgeois society; it is a product of long-term negative structural and institutional changes in its system.

It is worth emphasizing that in some periods after the Second World War economic growth prevails over anti-cyclical and anti-crisis measures as an objective of long-term policy in the advanced countries. Cyclical development, however, is inevitable. At the beginning of the XXI century this trend again manifests itself in a drastic way foreshadowing disaster for the United States[5] and the developed capitalist world. The current global crisis (financial and economic) on its scale and effects is inferior to the Great Depression of the 30^{-ies} of the last century and is the most severe crisis of capitalism over the past 80 years.

In the fourth quarter of 2008, the average real GDP growth rate worldwide fell by -6.2% on a yearly basis, while in the first quarter of 2009 it decreased by -7.5%. Expectations at that time were that the world economy would shrink by -1.1% in 2009 compared to 2008, which would be the first annual decline in global production for more than half a century.

The manifestations of the crisis are felt real by almost all countries in the world, directly or indirectly, to one degree or another, but its epicentre logically are the United States – the most developed nation of the world. Like during the Great Depression, now the capitalist system faces disturbances which may call into question its very existence. Thus both in the past and now the decision is sought in the expansion of state intervention in economic life as a means of survival. [6]

Facing the trend of a "freefall" of the United States economy, the newly elected President Barack Obama in his first press conference stated, that a failure for his plan for economic recovery to be activated „could turn a crisis into a catastrophe". Stating that „it is absolutely true that we can't depend on Government

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[4] Due to the great importance of the problem it is studied by other Bulgarian authors (see e.g. Tsarevski, V. (2010). The global financial and economic crisis - possible questions and answers - Economic Thought, N 3, pp. 23-36; Vladimirov, V. (2010). Fiscal policy in the economic crisis. - In: Ninety years EU Varna, p. 58-69; Angelov, I. (2010). The global economic crisis and Bulgaria. Sofia: Izdatelstvo na BAN).

[5] It is denoted as "the Great Recession". It should be borne in mind that macro-economic theory distinguishes "recession" to denote "minor declines in business activity" from "deep sharp declines in production." In practice, the difference is eliminated and "recession" as a term is used for conditions of a deep economic crisis, such as for example the current global financial crisis. This is hardly precise in theoretical terms, but the use of the term "recession" instead of "crisis" is something established in world literature.

[6] Keynes makes a significant conclusion. Unlike the opponents of „the enlargement of the functions of government", seeing in it „a terrific encroachment on individualism", he writes: „I defend it, on the contrary, both as the only practicable means of avoiding the destruction of existing economic forms in their entirety and as the condition of the successful functioning of individual initiative" (Keynes, 1936, p. 372).

alone to create jobs or economic growth“, he underlines: „But at this particular moment, with the private sector so weakened by this recession, the Federal Government is the only entity left with the resources to jolt our economy back into life. It is only Government that can break the vicious cycle where lost jobs lead to people spending less money, which leads to even more layoffs“ (Obama, February 9, 2009).

It is remarkable that this is also recognized by his predecessor George W. Bush (an outspoken supporter of the ideology of Reaganomics and neoliberalism) at the end of his reign. Before Obama took power G. W. Bush said that his administration is ready to intervene in the fight against recession, watching the markets destroy themselves.

The following evaluation that found place in the influential British weekly magazine „The Economist“ is indicative for the critical state of the United States economy: „Not since 1933 had an American president taken the oath of office in an economic climate as grim as it was when Barack Obama put his left hand on the Bible in January 2009. The banking system was near collapse, two big car manufacturers were sliding towards bankruptcy (referring to General Motors and Chrysler – author's note) and employment, the housing market and output were spiralling down.“ Further one reads: „Seven weeks before Mr Obama defeated John McCain in November 2008, Lehman Brothers collapsed. AIG was bailed out shortly afterwards. The rescues of Bank of America and Citigroup lay ahead. In the final quarter of 2008, GDP shrank at an annualised rate of 9%, the worst in nearly 50 years“ (The Economist, 2012, p. 17).

Given the accelerating explosive situation hanging over the US economy, later, after the worst predictions did not come true, President Obama recognized that the United States had faced destruction. It is worth noting that the development of emergency anti-crisis measures of the new administration to address the "free fall" of the American economy includes economists, although their behaviour is in contradiction with their conservative social philosophy.

The American Recovery and Reinvestment Act envisages $800 Billion, although economists, related to Obama's administration insist for even bigger amounts. Christina Romer, acting Chairman of the Council of Economic Advisers of President Obama originally proposed a package of $1.8 Trillion, but there were proposals for even greater amounts. The approved amount is unprecedented in US history (The Economist, 2012, p.18).

Coordinated unprecedented actions to suppress the uncontrolled decline of American and world economy

The role of monetary policy

In the conditions of the imminent danger of depression like the one in the 30^{-ies} of last century at the beginning of the crisis, governments and leading central banks urgently implemented extinguishing measures through unprecedented by

scale fiscal and liquidity packages. These measures have no alternative, although at the expense of the very large increase in the amount of public debts. In this way, however, is prevented a repetition of the devastating effects typical for the previous depression, with large declines in production and mass chronic unemployment. In the statement of the Summit of September 9, 2009 the leaders of the G-20[7] characterised the outcome of the measures as "the largest and most coordinated fiscal and monetary stimulus ever undertaken" (Group of 20, 2009).

In the beginning of the crisis, the role of monetary-lending policy is in the coordinated by the major central banks significant interest rate cut of 50 basis points on October 8, 2008, in an attempt to increase liquidity and to boost confidence in the financial system. By March 2009, the Federal Reserve, the Bank of Japan, and the Bank of England had all cut rates to 0.5 percent or less, with the Federal Reserve and the Bank of Japan approaching the zero nominal lower bound. They were joined by the Central banks of Canada and Switzerland. The European Central Bank (ECB) responded slightly more slowly but still cut its policy rate more than 3 percentage points to 1 percent.

In addition to the coordination of interest rate cuts, another important form of international coordination across central banks is the use of the unconventional system of liquidity swaps. The aim is to respond to the shortage of liquid resources in the global economy. Based on partnership agreements, the Federal Reserve purchased foreign currency in exchange for U.S. dollars and at the same time agreed to return the foreign currency for the same quantity of dollars at a specific date in the future. In these operations the Federal Reserve received interest equal to what the foreign central banks were receiving on the lending operations.

The Federal Reserve first used these swaps in late 2007 on a relatively small scale. From August 2008 through December 2008 these swaps increased from $67 Billion to $553 Billion. This massive supply of liquidity was larger than the available lending facilities of the IMF. The United States extended this program to major emerging market countries as well on October 29, 2008, providing lines of up to $30 Billion each to Brazil, Mexico, Singapore, and Korea (ERP, 2009, p. 96).

Swap lines were provided also by the European Central Bank to the European countries' central banks, aiming to decrease the pressure on the financial markets. In the Chiang Mai Initiative various Asian central banks set up swap lines that could be used in an emergency. However, together they totalled $90 Billion, far less than the available Federal Reserve swap lines.

The IMF's role has changed considerably over time, from being the shepherd of the world's Bretton Woods fixed exchange rate system to become a crisis manager (ERP, 2010, p. 101). As the IMF's resources were expanded triple in the new circumstances, this allowed for the conduction of two new types of interventions: *first*, emergency lines of credit (called Flexible Credit Lines) with Colombia, Mexico, and

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[7] The G-20, which includes 19 nations plus the European Union, was the locus of much of the coordination on trade policy, financial policy, and crisis response (ERP, 2010, p. 100).

Poland, which in total are worth over $80 Billion. These lines were intended to provide immediate liquidity to these countries, with the aim not to allow the running out of their financial reserves. *Secondly*, the IMF also negotiated a set of standby agreements with 15 countries, committing a total of $75 Billion. IMF analysis suggests that this program discouraged large exchange-rate swings in these countries (ERP, 2010, p. 102).

After 2009 the actions of the Federal Reserve are aimed at supporting the recovery of the US economy and they continue also in 2011. Monetary policy remained accommodative throughout the year, with the Federal Open Market Committee (FOMC) maintaining a target range for the federal funds rate of 0 to 0.25 percent "for an extended period" (ERP, 2012, p. 41-42). To ease conditions in financial markets, these exceptionally low levels for the federal funds rate remained unchanged at least through mid-2013 or even late-2014 (ERP, 2012, p. 42).

The changes in the policy of the Federal Reserve, that came with the current Great Recession, which coincided with the coming to power of Ben Bernanke a year earlier, are subject to different interpretations by analysts. In this regard special attention should be paid to the views of Nouriel Roubini – the economist, who forecasted exactly the year in which the American bank system would collapse.

Roubini assesses the role of the new Federal Reserve chairman this way: „To that end, Bernanke revolutionized monetary policy, directing a stunning series of interventions into the financial system, that even today few people understand… They ran the gamut from conventional monetary policy—slashing interest rates to zero, for example - to unprecedented measures heralding a massive expansion of the Federal Reserve's power over the economy" (Roubini, Mihm, 2010, p. 136). Roubini assumes that these interventions probably did help avert a Great Depression, but underlines that they raise a host of unsettling issues. According to him, the rush of the Central bank to prop up the financial system may prove conducive to moral hazard on a grand scale as well as to the rescue of both illiquid and insolvent financial institutions. Regarding this he warns that: „That precedent may be hard to undo and, over the long run, may lead to a collapse of market discipline, which in turn may sow the seeds of bigger bubbles and even more destructive crises" (ibid.).

Roubini points out yet another aspect as a strong argument - „the fact that some of Bernanke's monetary policies infringe on the traditional fiscal powers of elected government—namely, the power to spend money"(ibid.). He has in mind the practice to swap safe government bonds for toxic assets and, more radical, to purchase toxic assets and hold them on the balance sheet of the Federal Reserve. According to Roubini "Such measures, even if they prove effective, amount to an end run around the legislative process" (ibid., p. 137). Finally the author states: "Bernanke's response, orchestrated by himself and other central bankers, offers a glimpse of the unorthodox ways in which monetary policy can be used – and perhaps abused – to prevent a crisis from spiralling out of control" (ibid.).

This is Roubini's final conclusion on the issues that the Federal Reserve of the USA and its management face in the unfavourable conditions of a freefall of the economy that could lead to a repetition of the Great Depression of the 30^{-ies}.

The role of fiscal stimulus

The measures of monetary policy are firstly applied to suppress the decline of the global economy. However, since it is clear that they are insufficient to restore economic growth, fiscal stimulus comes forward, i.e. fiscal policy takes key role in this respect. The basis of this understanding is that this policy has a greater potential to impact the level of aggregate demand compared with the monetary policy. Moreover, in the meantime it became apparent that its anti-crisis capacity has reached its maximum, because interest rates in the major central banks in developed countries had decreased to values close to zero.[8]

The process of generating large amounts of fiscal stimulus, however, can cause excessive growth of budget deficits and public debts, which would impose a double challenge to the advanced industrial economies – of deflationary and inflationary trends. The efforts of governments to achieve fiscal consolidation expressed in drastic cuts in public spending as well as in tax increases are contributing factors to the development of the first trend. However, as far as the "monetization" of sovereign debt is possible, this mechanism is a conductor of the second trend. The fact that central banks injected large amounts of liquidity to stabilise bank systems also contributes significantly for its development. Such a complicated situation limits the effectiveness of the instruments of macroeconomic policy, as it has to carry out two mutually exclusive goals with a significantly limited impact. The consequences could be weaker results in terms of both anti-crisis and countercyclical measures, as well as of the dynamics of potential and actual rates of economic growth in the long run.

By the beginning of 2009, many countries decided to institute substantial fiscal stimulus as a measure to manage the collapse of private demand.[9] The share of these incentives as a percentage of GDP for 2009 is the largest in China, South Korea, Russia and Saudi Arabia - in each of them it exceeds 3%. In Japan, the rate was 2.9% and in the United States amounted to 2% - the average value in the G-20. The lowest shares of the fiscal stimulus in the three largest European economies - Germany (1.6%), France (0.6) and Italy (0.1%).

[8] „Monetary policy acted as a first line of defence against the crisis but conventional measures appear to have reached their limits in many countries. Policy interest rates in many countries--including the U.S., U.K. and Japan--are now close to the zero nominal interest rate floor. Moreover, the implosion of financial systems in many economies has rendered monetary transmission mechanisms far less effective" (Prasad and Sorkin, 2009, p. 1).

[9] At the November 2008 G-20 Summit in Washington, DC, the leaders of the G-20 countries promised to "use fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability" (Prasad and Sorkin, 2009, p. 1).

Table 1

2009 Fiscal Stimulus as Share of GDP, G-20 Members (%)

Argentina	1,5	Japan	2,9
Australia	2,9	Mexico	1,6
Brazil	0,6	Russia	4,1
Canada	1,8	Saudi Arabia	3,3
China	3,1	South Africa	3,0
France	0,6	South Korea	3,7
Germany	1,6	Turkey	2,0
India	0,6	United Kingdom	1,6
Indonesia	1,4	United States	2,0
Italy	0,1	*All G-20 Nations*	*2,0*

Note: Values are average of International Monetary Fund and Organisation for Economic Co-operation and Development estimates for nations with expansionary fiscal policies.

Source: Horton, Kumar and Mauro, 2009; OECD, 2009a, cited as in ERP, 2009, p. 98.

The two countries in this exercise with the largest stimulus packages, Korea and Japan, outperformed expectations by dramatic amounts. Countries such as Italy that had virtually no stimulus performed worse than most. Among non-OECD countries, China had one of the largest fiscal stimulus packages, and in the second quarter of 2009 its growth was both rapid and far in excess of what had been expected in November 2008. Fiscal stimulus seems to have been important in restarting world economic growth in the second quarter of 2009 (ERP, 2010, p. 105-106). The same report notes that growth has recovered quickly in countries with large fiscal packages in the second quarter of 2009, although they have weaker automatic stabilizers than countries with smaller or medium-sized fiscal stimulus.

Table 2

Stimulus and Growth in Advanced G-20 Countries

	Stimulus (% of GDP)	Stabilizers (% of GDP)	Growth during:	
			Crisis (%)	2009-Q2
High stimulus	3,2	28,4	-7,1	5,4
Mid stimulus	1,7	35,3	-8,3	-1,3
Low stimulus	0,3	43,2	-7,4	-0,3
United States	2,0	28,0	-5,9	-0,7

Source: Horton, Kumar and Mauro, 2009; OECD, 2009a, cited as in ERP, 2009, p. 104.

After the second quarter of 2009, the relationship between stimulus and growth weakens somewhat. High-stimulus countries still exceed expectations relative to low-stimulus countries, but the relationship is not statistically significant (ERP, 2009, p. 105). After that the dynamics of global economic growth weakens which could be due to the insufficient size of financial packages as share of countries' GDP.

Here we pay a special attention to the paper of Presad and Sorkin, as it contains more comprehensive data on the size of the financial stimulus in the G-20 countries, on the structure of their packages, on the speed financial measures take place. The paper summarises data as announced by the authorities and compiled by the IMF, as well as data from other sources used by the authors for a basis for their calculations.

The G-20 countries in this analysis (substituting Spain for the EU) constitute over three-quarters of global GDP (on a market exchange rate basis) and over two-thirds of the world's population (Prasad and Sorkin, 2009, p. 2). Based on the size of the stimulus countries are divided into three groups: frontloaded, modest and unimpressive.

The total amount of stimulus in the G-20 amounts to about $692 Billion for 2009, which is about 1.4 percent of their combined GDP and a little over 1.1 percent of global GDP (ibid, p. 2). The amount, however, appears to fall short of what is needed to tackle a crisis of the proportion we are currently in. The IMF, for instance, has called for stimulus equal to 2 percent of global GDP. The U.S., China and Japan - account for about $424 Billion of the overall stimulus in 2009, with their shares in the overall global stimulus amounting to 39 percent (U.S.), 13 percent (China) and 10 percent (Japan).

In 2010, the U.S. accounts for over 60 percent of planned stimulus. China and Germany are the next largest contributors with China contributing 15 percent of G-20 stimulus and Germany contributing 11 percent. Measures for 2010 in the U.S. stimulus package amount to 2.9 percent of 2008 GDP, China's 2.3 percent, and Germany's 2.0 percent.

The authors make the reasonable conclusion that the size of the stimulus varies substantially across countries, with some of the stimulus packages looking downright meek. In this respect, as a typical example they refer to France which has proposed measures amounting to only 0.7 percent of GDP in 2009.

Another characteristic trend is that most countries that have announced multiple waves of stimulus have increased the share of spending (compared to tax cuts) in the second round. This applies to the US from January 2008 to January 2009. Germany's stimulus in November 2008 was largely composed of tax cuts. The second stimulus package announced in January 2009 was largely tilted towards spending. Similar features can be found in the stimulus measures announced in Australia in October 2008 and February 2009, and in Spain in March 2008 in November 2008.

As one could see, there is a great deal of variation across countries in the share of the stimulus that is devoted to tax cuts. In the U.S., this share is about 45

percent. Some countries - including Brazil, Russia and the U.K. - have focused almost entirely on tax cuts. Others - including Argentina, China and India - have mostly proposed spending measures. Among the G-20 countries excluding the U.S., about one-third of the stimulus is accounted for by tax cuts and the remainder by spending measures.

The study mentions another significant aspect regarding to "the speed with which the tax and expenditure measures hit the real economy ant the way money reaches the pockets of firms and households, or government monies being spent on social programs or procurement" (Prasad and Sorkin, 2009, p. 3).

In the concluding part of the paper the authors outline the crucial role Fiscal stimulus has to play in stabilizing the world economy, especially as conventional monetary policy appears to have reached its limit in many countries. They noted that "Some countries like China and the U.S. have responded forcefully, with impressive packages. But the execution, both in terms of size and speed, leaves much to be desired in some of the G-20 countries" (ibid., p. 4).

There are legitimate questions about the effectiveness of fiscal stimulus, especially in economies where the financial system has broken down and where monetary policy can no longer play much of a supporting role. Moreover, excessive government borrowing to finance large budget deficits could itself generate instability and there are serious concerns about medium-term sustainability of fiscal positions in economies that are building up public debt at a rapid pace. "Given the dire and fast-deteriorating economic situation and the lack of other tools, however, the world may have little choice but to engage in massive frontloaded fiscal expansion. The consequences of timidity, as history teaches us, could be even worse."

To summarise, one comes to the conclusion that some unconventional changes in the monetary and fiscal policies have been undertaken to manage the global crisis in its beginning, with the leading international financial institutions standing behind them – the IMF, the Federal Reserve, the ECB, the Central banks of England and Japan. After overcoming the most dangerous manifestations of the crisis, at the meeting of the G-20 at the end of 2009, the IMF recommends to the governments to strengthen measures to preserve the stability of the financial system. Indicative is the fact that at the same time the disproportionate nature of the premature termination of the anti-crisis measures is highlighted. This position is a result of fear that such a decision could lead to a new recession. It is worth noting that the developed economies at that time still keep interest rates at a level close to zero. This is due at least to two reasons - not to create conditions for greater fluctuations in securities, the emergence of balloons and their burst, and to maintain the level of spending on servicing government debt.[10]

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[10] "The recovery in the four years after Franklin Roosevelt took office in 1933 "was incredibly rapid. Annual real GDP growth averaged over 9%. Unemployment fell from 25% to 14%." The achieved results created social pressure that led to the abolition of the stimulating fiscal and monetary measures, which in turn leads to „a second severe downturn in 1937-38".

The financial crisis in the US: genesis, causes, phases and its development to a global phenomenon

Emerging in the USA, the first signs of the crisis occurred in late 2006 and early 2007. Then housing prices eventually levelled off, and the first nonbank mortgage lenders specializing in subprime loans failed after growing defaults among borrowers.[11] The second stage came in in June 2007 two highly leveraged hedge funds managed by Bear Stearns, which had invested in securities backed by subprime mortgages, collapsed, triggering a flight from all securities associated with the subprime market. Roubini draws the following conclusion regarding this unfavourable trend: "As awareness mounted that exposure to subprime mortgages was ubiquitous throughout the global financial system, panic spread" (Roubini and Mihm, 2010, p. 34).

As with so many panics taking on the financial markets, uncertainty drove decisions and lead to the increase of the speed of the devastating processes in 2008. Thus were created the conditions for the emergence of a third phase of the crisis in the US financial system, whose manifestations are described as follows: „After more than three hundred nonbank mortgage lenders collapsed… The next step was the swift demise of Wall Street's major investment banks – Bear Stearns was first, followed later that year by Lehman Brothers. Merrill Lynch would have collapsed too, had it not been sold to Bank of America. Goldman Sachs and Morgan Stanley dodged the bullet by turning themselves into bank holding companies, gaining access to lender-of-last-resort support from the Federal Reserve in exchange for submitting to greater regulatory oversight" (Roubini and Mihm, 2010, p. 35).

The further development of the financial crisis is related to the continuing run on the shadow banking system continued with a run on the $4 Trillion money-market-fund industry, as well as with the collapse of the market for still more exotic instruments.

This process reached new and dangerous levels in late summer and fall of 2008. Together with the massive run on the assets of the entire banking system and the collapse of Lehman Brothers, AIG teetered on the brink, threating to paralyze the system of global credit and money markets, which could lead to problems in the financing of imports and exports in the global economy. In this extremely dangerous environment the Federal Reserve saw no other option than to do what had eventually

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Taking into account the lessons learned from the historical experience of the United States during the Great Depression, Christina Romer (Chairman of the Council of Economic Advisers of President Obama) is against the premature suspension of the anti-crisis measures not only in America but in the world. According to her: „The 1937 episode provides a cautionary tale. The urge to declare victory and get back to normal policy after an economic crisis is strong. That urge needs to be resisted until the economy is again approaching full employment. Financial crises, in particular, tend to leave scars that make financial institutions, households and firms behave differently. If the government withdraws support too early, a return to economic decline or even panic could follow. In this regard, not only should we not prematurely stop Recovery Act spending, we need to plan carefully for its expiration. … I can see that the pressures they were under were probably enormous. Policymakers today need to learn from their experiences and respond to the same pressures constructively, without derailing the recovery before it has even begun" (Romer, 2009, p. 2-4).

[11] The chronology of the financial crisis is presented as in Roubini и Mihm's „Crisis Economics" (2010).

been done in the Great Depression: "it became the lender of last resort and gave deposit insurance to a new generation of banks. Nonetheless, the fallout from Lehman's collapse and the resulting financial meltdown in the fall of 2008 led global credit and money markets to seize up" (ibid., p. 36).

The humdrum business of global imports and exports threatened to collapse, as companies could no longer secure the financing necessary to move goods from one country to another.

By the end of the year, the crisis had spread far beyond the United States, reverberating from China and Japan to Ireland and Iceland. Many of the same problems that bedevilled the United States – such as a real estate bubble, were present throughout the world. Thus, while beginning as a process developing within national borders, firstly as a collapse of mortgage markets, followed by the downfall of the whole banking system, the logical end of this process was that the financial crisis in the USA expanded to a global financial crisis.

The Anatomy of the Great Depression and the Great Recession

Fundamental similarities and differences

Their common basic feature is that they are the two cyclical crises of greatest scale that the history of capitalism knows. The fundamental difference between these two crises is the fact that the Great Depression is characterised by a significantly larger-scale economic and social turmoil and upheaval than the current Great Recession. As already pointed out, thanks to the concerted urgent action to suppress the "free fall" of the global economy the current global recession has not developed into depression.

The specifics of the Great Depression (1929-1932) with the subsequent stagnation that lasted until the end of the 30s, is expressed in the unprecedented large scale of mass chronic unemployment, which became the most significant challenge to capitalism as a social system. Only when the US economy passed on wartime rails, there was a significant reduction in the unemployed labour force. Despite the state of deep crisis economic theory and practice at the time was to find a solution to a less complex task with many parameters, such as it is in the current conditions. Then the problem was in ensuring "full employment", which was achieved with the practical application of the principle of the need to ensure effective demand based on the realisation of a macroeconomic policy of Keynesian type. Even before the advent of the "General Theory" by J. M. Keynes governments understood that "the root of evil" is the shortage of aggregate demand and therefore started to increase government spending to go out of the depression.

As already mentioned, in the current global recession the crisis of the capitalist system is facing a far more complex reality, with more multifaceted characteristics compared to the period of the Great Depression.

Contrary to the statements of the American philosopher F. Fukuyama about the occurrence of the end of the world, the inevitability of the establishment of the

liberal model of the West as a universal model after the collapse of communism in the Soviet Union and in Eastern and Central Europe, in fact, the trend actually observed is to a crisis of the unipolar world under the domination of the United States as a result of the emergence of a multipolar world with a new geopolitical configuration. In particular, it is expressed in the formation of a new institutional structure – the BRICS, which includes Brazil, Russia, India, China and South Africa. The creation of this organization puts an end to the dominant position of the US in the world economy, and due to the high share of fiscal stimulus in China, Russia and South Africa contributes to the weakening of the global recession.

As a difference one should note the fact that the burden of government debt is disproportionate to that in the 30-ies of last century, compared with their huge size in the current environment. A common feature of the two crises, however, is that they are preceded by a big crash on the New York Stock Exchange, accompanied by a sharp fall in prices of the securities which is quickly transferred to stock exchanges in other countries.

A specific point relevant to the genesis of the Great Recession, is of late 70s period of unusual calm development in most advanced economies. It is characterized by low inflation, high rates of economic growth and milder recessions. This period is named the "Great Moderation" (Roubini, and Mihm 2009, p. 26-27), given that Western economies have entered in the trajectory of optimal development. However, expectations are refuted by the crisis processes, which spread over the global economy.

Another difference is that at the time of the Great Depression, the current global crises did not exist – ecological, concerning environmental pollution, global warming and the depletion of the planet's resources; demographic, associated with uncontrolled population growth in large areas of the world and population aging in developed countries; unprecedented by scale manifestations of contemporary international terrorism; the broadening of the gap between the developed and poorest countries, etc. Global crises in modern conditions are the greatest challenges humanity faces.

Comparative dynamics of macroeconomic and sector indicators[12]

If we measure the depth of the current recession in annual rates it is very mild on a world scale. World economic output still increased in 2007 and 2008 (by 5.2% and 3.2% respectively) and is predicted to decrease by 1% to 2% in 2009, namely it is predicted to be 3% in the USA, 4% in the EU, and 5% in Japan. Among the large countries the strongest decline will probably occur in Germany with 5% in 2009 (Aiginger, 2009, p. 5).

Moreover, during the Great Depression the decline in GDP of the US is 28%, in Germany – 16%, in Austria – 22%. Unemployment during the Great Depression

[12] This part of the paper is based on the studies of the Austrian economist Karl Airinger (see. Aiginger, 2009, 2009a).

jumped from 3% in 1929 to 15% in 1932, reaching 25% in Austria and the USA, and 30% in Germany (16% in the United Kingdom). In the Current Crisis it started with levels between 5% and 8% in most industrialized countries, and the unemployment rate is bound to reach the 10% mark in the EU and the USA (ibid, p. 42).

Employment decreased by 16% on average across countries in the Great Depression (-14% in the USA, -29% in Germany). Employment loss is forecast to be 2.6% in the EU in 2009 and 3.5% in the USA. Switching to quarterly or monthly data (wherever possible) and looking at the speed of the decline shows that for manufacturing, exports and stock prices there are several months or quarters where the speed of decline between the Great Depression and the Current Crisis had been similar or even larger in the Current Crisis (ibid, p. 42-43). The higher degree of synchronization in the current crisis than the Great Depression determines the possibility of faster "contamination" of the countries of this recession - its transfer from the US in the EU and Asia.

For the stock markets the decline was at first smaller in the lingering phase of the Current Crisis, then between August/September 2008 and February/March 2009 much steeper (if we include the last rebound of stock markets since March 2009). The paper we use contains the following important statement: „The similarity of the speed of decline, even if only over a few months and with regards to the most volatile indicators, demonstrates that the potential for a much steeper recession existed in the Current Crisis. It furthermore indicates very strongly that the difference in economic policy between the Great Depression and the Current Crisis mattered."

The paper underlines that additionally two institutional factors helped slow any decline. The first is a result of the change in the structure of Western economies – manufacturing is today only a much smaller part of the economy, while service sector and public sector are larger. The second is related to the role of the countries on the "periphery" – countries which do not lead in per capita income and which were not at the epicentre of the crisis.

Conversely, the new waves of globalization have a pro-crisis and pro-cyclical impact and through the transfer of innovation and the intensification of trade flows can create preconditions for the emergence of longer and more synchronized crisis, as evidenced by the recent global crisis. In addition to that Aiginger underlines the significance of financial globalization and intensified trade relations that could have had the potential to create a longer and much synchronized global crisis (Aiginger, 2009, p. 43).

The role of economic policy

World economic output increased by 45% between 1921 and 1929. By contrast this time world output increased very steadily between 1990 and 2008. Growth amounted to 84% (3.5% p.a.) with no absolute decline in world GDP, in the USA and most European countries. The only exception among developed countries was Japan, which experienced a prolonged crisis between 1992 and 2003 (the "lost decade"). The

smaller increase in the Great Depression is due to the more serious nature of the crisis of 1921.

Generally, there is the following relationship: with a substantial increase in GDP, its greater value is ceteris paribus a factor for a substantial decrease in production. In the Great Recession, however, this is not confirmed – here is reported a substantial increase in production, as here economic policy plays a crucial role for suppressing the "free fall" of the global economy.

The Great Depression started with the stock market crash (October 1929) hitting economies at the downturn of a business cycle. This was followed by a breakdown of world trade, then by a wave of bank runs and bank failures. A crucial role for the more substantial decrease in production and the larger sizes of chronic unemployment played inadequate response to the economic policies and actions of governments in the US and Western Europe. These actions followed the logic of automatic rules of conduct and therefore were counterproductive to the nature of the Great Depression, to deal with which necessary were discretionary non-standard measures such as "precise adjustment" (fine tuning)

Here is how Aiginger characterizes the nature of the actions taken then: „Economic policy reacted lenient, indecisive and late. Monetary policy was restricted by the gold standard and was applied in an asymmetric, restrictive way. The fiscal policy tried to balance budgets and prevented automatic stabilizers from working. Competitive devaluations, rising taxes and tariffs, and finally a premature reduction of deficits (in the USA in 1937) increased the length of the Great Depression.“ From that comes the significant conclusion: „It was the length, not the initial speed, of the Great Depression, which made the cumulative decline in output and employment that large. This time (referring to the current global recession – author's note) the speed in the beginning was high, mitigated by some new economic characteristics and by decisive and - at least partly coordinated - policy measures… monetary as well as fiscal multipliers are very different between then and now“ (Aiginger, 2009, p. 43).

The significant difference in economic policy of Western countries during the world economic crisis and the current global recession is also noted. The author states: „In contrast to the Great Depression, where poor policy actions - monetary, fiscal, regulatory, and protectionist - helped turn a sharp global downturn into the worst worldwide collapse the modern economy has known, the recent massive policy response helped supress the spiralling of this Great Recession“ (ERP, 2010, p. 102).

Economic literature specifically emphasises the strong negative impact of the introduction of protectionist measures in world trade in the early 30ies – tariffs, import quotas and currency restrictions. They are considered by individual countries as a means to quickly overcome the Great Depression, but trade barriers designed to limit the cost of foreign goods practically lead to a sharp contraction in world trade. Thus a policy known as "beggar-my-neighbour policy", contributes not only to the intensification of the crisis, but later, after the world economic recovery continues to

have adverse consequences for the world trade and economic growth (Eichengreen and Irwin, 2009, p. 2).

Under the new conditions the effects would be significantly unpleasant, especially for the real economy (decline in production and increase in unemployment), if governments had not intervened at the outset with measures to counter the global crisis unlike the passive behaviour at the beginning of the global economic crisis of 1929-1932. Now the government, primarily the US, followed by those in Europe, Japan, China, Russia, etc., did not stand aside as passive observers and thanks to the use of very large fiscal and liquidity packages it did not come to the worst – to repeat the effects of the Great Depression of the 30-ies of last century.

Controversial trends in global economy

The most dangerous manifestations of the global financial crisis are mitigated at least for now. However, the average rates of economic growth in the world economy and in developed countries remain lower than in previous periods of deeper crises. The situation with the size of unemployment is even more unfavourable, especially in the EU, to which the policy of strict enforcement of fiscal discipline greatly contributes. It is reflected in the requirement for compliance with the maximum of a deficit of 3% of GDP.

Such an economic strategy leads to a serious weakening of investment costs without which it is not possible to stimulate economic growth and increase employment. The negative effect of the cuts on investment is recognized by IMF chief economist Olivier Blanchard. According to him „reducing deficits, which now is much more common in Europe than in the US, has significant impact on growth. If reviewed country by country, one will conclude that those that have the most drastic plans to reduce investment, have the lowest growth“.[13]

The program to secure €327 Billion investments for Europe announced by the new President of the European Commission Jean-Claude Juncker is a reaction to the negative effects from the policy of drastic savings. Probably the stated goal, however, is not compatible with the intention to continue to maintain fiscal discipline as an indestructible principle. Moreover, it is not clear based on what mechanisms and incentives the private sector could actually be interested in inclusion in the realisation of the investment program.

Better results were achieved in the US thanks to the implementation of a more flexible policy aimed at stimulating economic growth and employment – this policy follow the recommendation of Keynes not to cut excessive government spending and those for investment in an economic crisis. The 2014 address of US President Barak Obama to the US Congress „describes how after 5 years of grit and determined effort, the United States is better-positioned for the 21st century than any other nation on Earth. We've now experienced 4 straight years of economic

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[13] IMF. 2012. Austerity strongly inhibits economic growth.

growth with more than 8 Million new private-sector jobs. Our unemployment rate is the lowest it's been in more than 5 years. Our deficits have been cut by more than half" (ERP, 2014, p. 3). The positive development in the United States is due to the following of a Keynesian policy thanks to which the economy has avoided the vicious spiral of a new recession.

In the address, however, he admits that „ in many ways, the trends that have threatened the middle class for decades have grown even starker" (ibid.). Actually its scale not only in the US but worldwide has reached unprecedented proportions. Without achieving a significant turnaround not only the survival of the middle class, but also the restoration of sustainable growth in the global economy is threatened in this respect, without which it is impossible to ensure stability of democratic institutions.

An unfavourable factor are the e signs of a tendency towards deflation in the world. Overcoming it may be even more difficult than that of inflation, which is visible from the bitter ten-year experience of Japan in the 90-ies. As a phenomenon, it creates a negative impact on investment and consumer spending. The impact of deflation, however, is particularly harmful on the debt of households, businesses and governments. Causing their actual appreciation, it hampers their payment.[14] In the article „The pendulum swings to the pit", in „The Economist" (25-31.10.2014) is stated: „Politicians and central bankers are not providing the world with the inflation it needs." There is also noted, that „some economies face damaging deflation", and then: „…It is a pernicious threat, all the more so because, at its onset, it seems almost benign … But the stable low inflation fought for in the 1980s and 1990s and inflation hazardously close to zero are not so far apart. And as inflation drops, slipping into deflation becomes ever easier. It is in that dangerous position that the world now stands…"[15]

It turns out that in the US, UK and Eurozone central bankers aim at inflation of 2%, but in reality it is below this benchmark. This applies to Italy, Spain and Greece, as well as Sweden and Israel. The same problem refers to Japan as well, which in 2013 was able to finally get out of deflation after more than a decade-long battle, but over which again hangs the same danger. Even in China inflation is less than 2% at a governmental aim of 4%.

Given the data, it is clear that the path along which the Western economies (US, EU, China) moved can be characterized as wandering between two evils, i.e. to paraphrase the famous metaphor – between Scylla and Charybdis. The precarious state of the world economy is further aggravated by the deterioration of relations between Western countries and Russia and the imposed economic and financial sanctions that could have a negative impact on global growth and employment.

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[14] The term debt deflation is introduced for the first time in economic theory by Irving Fischer to whom Joseph Schumpeter refers to as "the greatest American economist".

[15] The Economist. 2014. The Dangers of Deflation…, p. 23. See also The Economist, 2014. The World Economy…, p. 16-18.

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