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The Current Global Economic Crisis: Gleaning from History

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Abstract: The study seeks to demonstrate how the knowledge of economic thought could help in explaining and managing the current global economic crisis. The current economic meltdown has affected nations of the world by differing degrees but adversely. Many analysts argue that the adoption of the Washington Consensus-financial liberalization-gave vent to the crisis. The Washington Consensus discourages government involvement but promotes the operation of the market forces in economic and financial operations. However, the financial and economic devastation caused by the current economic crisis has prompted governments of various nations across the world to intervene through massive stimulus plans in order to rescue their economies from the meltdown situation. This suggests that the role of government in the economy is pertinent, and that the market forces are no substitutes but complement. This, therefore, suggests a fair balance of the government and the market forces in the operations of the economy.

Key words: Economic crisis, government, intervention, liberalization, Washington Consensus

INTRODUCTION

The economy, be it national or global, may be equated with a living organism, which is subject to wonted vicissitudes of life, therefore, it is expected to experience peaks through booms and troughs through recessions (or depressions). When an economy is jolted towards (or to) the trough for a period longer than expected recovery, the economic structures (principles) upon which the economy was operating may need to be re-evaluated and reappraised. It may call for a change of some of the operational principles, or there may be need for restructuring of the principles to aid the economy recover from the downturn situation. The current global economic and financial crisis which emerged in August 2007 following the collapse of the mortgage sector in the US due to sub-prime lending - lending by financial institutions to high-risk customers at rates of interest higher than prime rates - has, indeed, jolted the global economy towards the trough. Many analysts and commentators, thence, have tended to blame the crisis on economists and economic ideologies (Essien, 2010). Precisely, the opinion is that the economic ideology and principles that guide the global economic system out of which the global financial system sprang, has lost its efficacy, thus the meltdown.

The attendant effects of the economic meltdown include crashing of stock markets, capital squeeze, shrinking investment, decrease in income, loss of jobs, loss of homes, starvation, hunger. How the economy should be organized and managed in order to guarantee optimal production and equitable distribution of goods and services for the well-being the society provides a fundamental basis for economic thinking in all societies - whether primitive or modern. Since the emergence of this current economic crisis in August 2007, various sects, schools of thought of differing opinions have explained causes of this economic phenomenon and the possible ways out. But then, the truth is that we cannot really explain and manage the present economic crisis without a proper grasp and gleaning of the past and the forces which induced changes in economic thinking overtime. The factors which engendered the current economic crisis can only be gleaned from historical perspective as it forms another page in the book of History of Economic Thought. This study seeks to demonstrate how the knowledge of economic thought has helped in explaining the current global economic crisis.

THE CONCEPT OF SCHOOLS OF THOUGHT IN ECONOMICS

Economic thought is studied within the context of the society and the forces which make for its evolution from one era to another. It is influenced by man's social and physical environment. There has not been uniformity in economic thinking because different people face different problems, and the forces which facilitate societal evolution differ from place to place, even within a particular historical period. Also, the responses of economic units (individuals, firms, governments, etc.) to phenomenon usually vary from one situation to another, in view of the prevailing moral, political, religious and social philosophy and also the institutional framework of the society (Bhatia, 1978). Accordingto Gruchy (Bhatia, 1978), a school ofeconomists means a group of scientists

whose work reflects a common intellectual orientation... their common orientation or world view is fountain head from which flows the unity that is to be found running through their economic thought. The unity which binds the members of a school of economists shows up in their framework of analysis, their psychological theory, and their scientific methodology. The founders of a new school may draw upon the ideas of their predecessors and develop them further, or they may react in opposition to earlier ideas that stimulate their own thinking in new direction (Oser and Blanchfield, 1975).Let us take a cursory look at the major schools of economic thought with respect to their theories, inferences and policy prescriptions.

A SYNOPSIS OF MAJOR SCHOOLS OF THOUGHT IN ECONOMICS

The forerunners: The forerunners were economic thinkers who put down some important ideas before the 18th century, which witnessed resurgence in economic thinking. The forerunners were mainly the Greek Philosophers, the Medieval or Scholastic Philosophers, the Mercantilists and the Physiocrats.

The Greek Philosophers advocated for private ownership of economic resources, frowned at usury in money lending and considered exchange as an unproductive activity.The Medieval/Scholastic Philosophers emerged (mainly in Europe) when the ancient Greece and Roman empires came to an end. Insularity of economic life and extreme self-reliance were the economic hallmark of this period.

They were generally more concerned with whether actions were just or unjust and their specific contributions were in the areas of the theory of value and price determination. They recommended the market determined prices (natural price or just price) and opposed the government determined prices. The philosophers in this period are seen as scholastic because their economic thinking was not so much to analyse what little economic activity was taking place but to prescribe rules of economic conduct, compatible with religious dogma.

Mercantilists sought to encourage national self sufficiency as they shifted attention to the problem of increasing wealth and power of various nation states. The basic idea of this school was that government should be involved in, and regulate the economy, so as to gain more national wealth and power (which were viewed in terms of more gold and silver). International trade was encouraged but promotion of exports and restriction of imports was their basic tenet. However, it is important to point out that Mercantilists were selfish in nature as their ultimate objective was not to improve the economic conditions of the people (as seen in low wages, restriction of consumption of certain goods, long hours of work, etc.,) but to enhance national wealth and power for their self enrichment.Physiocrats developed exclusively in France in reaction to the remnants of Feudalism and the excessive government regulation of certain activities which resulted from the mercantilists' ideas (Akpakpan, 1999) The unjust and inequitable tax system, existing side by side with a wasteful irresponsible and corrupt government, as well as the obvious realization (even to later mercantilists) that the national wealth did not consist merely in the accumulation of gold, gave room for more realistic approach in the enquiry into the source and nature of national wealth. According to the physiocrats, the primary source of national wealth was agriculture.

Their philosophy was based upon a 'natural order' (i.e. regularity of nature) and the human society was also viewed as being subject to the same natural laws as the physical world. Thus, they advocated for a system of private property and free enterprise (*laissez faire*) in the economy. To them, government should perform its traditional function of maintenance of law and order and should not interfere in the economy. People should be let alone to be free to use their ideas and decide on what to do, and make their own economic way. This school laid the foundation for the Classical school.

The classical school: The genesis of this school was marked by Adams Smith's *'Wealth of Nations'* and it developed through the work of David Ricardo, Thomas Robert Malthus, and culminates in the synthesis of John Stuart Mill, down to Alfred Marshall and A.C. Pigou. The Classical doctrine is frequently called 'economic liberalism' (or economic freedom). It emphasizes personal liberty, private property, individual initiative and control of enterprises. The school adopted the doctrine of *laissez faire*. Its members believe that natural laws govern economic activity and so, government should not intervene and regulate the economy, but should allow the natural forces of the market to direct and control the society's resources and production activities. In other words, people should be given the freedom to make their own economic choices. According to this doctrine, there is existence of harmony of interests and if individuals are given the economic freedom to seek their own interests, they will be guided by an 'invisible hand' to do the things that will serve the best interests of the society. But before this, Adams Smith, in his book, 'Theory of Moral Sentiments', had spelt out ethical issues in building a society, which must be considered, before the private enterprise system can work. One of the issues was the importance of honesty in dealing with people.

The Marxian School: The founder of the Marxian School, Karl Heinrich Marx (1818-1883) was fascinated

by the ideas of some great philosophers, commonly called, Pre-Marxists (later branded by Marx as *Utopian Socialists*). The Marxian school emerged in reaction to the evils and miserable features (especially great inequalities and exploitations) which characterized the *laissez faire* (*"capitalism"* - as named by Marx) system. Marx got his weapon from Ricardo's "Conflict of Interest" analysis of the market system. He learned and used the natural economic laws of the Ricardian Market System Model to show that the economic system described by the model contained within itself, "the seeds of its own destruction" (Bowden, 1985).

He looked at the entire system as being very "unjust" and therefore, called for the revolution of workers against the system, in order to change the status quo. The Marxian School supported movements to promote socialism (i.e., the handover of the ownership of production and enterprise to the society), trade unionism, and government actions to ameliorate the conditions, by regulating the economy, eliminating abuses and redistributing income (Oser and Blanchfield, 1975).It is worth noting that from the time of the Marxian School, and even up to date, there have been two intellectual struggles on how to organize the production and distribution of goods and services for the well being of the society. On one end are the supporters of private ownership of the means of production and on the other end are the supporters of society ownership and government control of the means of production.

The Neoclassical School: Neoclassical school is associated with the Marginalist Revolution of the mid 18th Century. Members of this school are also known as the Marginalists and they continued the Classical School's defense of *laissez faire* as the most desirable policy. The school distinctly prefers competitive markets to government intervention. It denounces socialism and discourages labour union. Advocates explain that the disparities in income and wealth are as a result of differences in human talents, intelligence, energy and combination. A major principle of this school is the concentration on the margin (i.e., the point of change where decisions are made) to explain economic phenomena (Oser and Blanchfield, 1975). The main policy conclusion of Neoclassical School is that government intervention to regulate the economy is unnecessary and brings about distortions.

The Keynesian School: The Keynesian School, founded by John Maynard Keynes (1883-1946) emerged as a result of the Neoclassicists inability to explain the prolonged great depression that lasted from 1929-1933. The market system, which was supposed to work out neatly by getting people to produce things for other people (and hence, guaranteeing a perpetual full employment, through Say's Law of the Markets) failed during the great depression and Keynes was worried about the failure. The basic tenet of the Keynesian School is found in Keynes's enduring work, 'The *General Theory of Employment, Interest and Money'*, published in 1936. Here, Keynes regarded the existing explanations of employment as meaningless (as neither high prices nor high wages could explain the persistent depression and mass unemployment).Keynesian School proposed an alternative explanation of the phenomenon and focused on what is termed, *'aggregate demand'* (that is, total spending of consumers, business investors and government bodies). The school explained that since there was a deficiency in aggregate demand, government should come into the economy and stimulate recovery by implementing certain fiscal policies. This prescription therefore forms the basic principle of the Keynesian School of Economic Thought. However, Keynesian economics has developed into Neo-Keynesianism (those who believe that the co-ordination problems of market can be solved with the *IS-LM*, aggregate supply/demand analysis), New-Keynesianism (those who just differ from Neo-Keynesianism mainly in terms of modeling techniques), and Post-Keynesianism (whose members advise that the best way to analyse the economy is not to develop abstract models, but to study the way institutions work and accept their existence without modeling). Post-Keynesians focus mainly on explaining why the economy does not work well (Anyanwu and Oaikhenan, 1995).

Some salient issues in economic thought: Overtime, the proponents of free enterprise system (*Capitalism*, as named by Karl Marx) have had upper hand and thus, the current economic crisis is existing in the capitalist setting. With this, we shall in this section look at some key issues (in Economic Thought) that have to do with the capitalist system.

Business cycles: Sunharam and Vaish (1981), describe business cycles as:

> "Types of fluctuations found in the aggregate economic activity of nations that organize their work mainly in economic enterprises. A cycle consists of expansion, occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals, which merge with the expansion phase of the next cycle. This sequence of changes is recurrent but not periodic".

In other words, business activities are characterized by normal cycles which manifest in recurrent periods of prosperity and booms (i.e., when employments, wages,

profits etc. are high) and periods of depression and slumps (when getting a job is hard, income falls continuously, and businesses are in "*convulsion*" and sometimes, close to their "*graves*").

Unfortunately, Neoclassicists generally ignore the issue of business cycle because of their strong conviction that J. B. Says law (that *"supply creates its own demand"*) will always hold. They believe that recurrent depression periods are necessary part of the system, and are short run self-correcting conditions which will always move to periods of recovery and prosperity. But obviously, during the 1930's (and even today), when there was economic turmoil and economies went into persistent slums (i.e., when output could not find enough buyers, when investment declined and factories shut down, thereby rendering many people jobless), Neoclassicists could not explain, nor give any solution to the problems.

Inversely, Karl Marx incorporated the issue of business cycles in his analysis. Iniodu and Ukpong (2001) maintain that Marx was the first major economist to notice that by the middle of the 19th century, "heavy unemployment was quite a frequent occurrence in the developing industrial countries of Western Europe", or the first to realize that the phenomena required an explanation. He not only built the "trade cycle" into his analysis, but also said it was an expression of the inner contradictions of the capitalist system. He expected the trade cycles to get progressively worse and to lead eventually to the collapse of the system.

Mattick (1980) gives a concise description of business cycles. To him, in periods of expansion, prices rise faster than wages and reduce individual worker's income, while enlarging the income of the *'class'* … At the beginning of a depression, prices fall faster than wages and the individual worker's lot improves while that of his 'class', which embraces the unemployed, worsens. At the height of prosperity, wages increase, which keep pace with or even outrun the rise in prices, and are largely a sign of the approaching crisis? The capitalist system, therefore, in all its phases, is considered to be rotating round the business cycle-depression, as a precondition to prosperity, prosperity comes to an end in a new depression, and then prosperity, and on and on. All, being caused by the contradictions between production and consumption, resulting from the fact that the *'surplus value'* is not given to labour, thereby limiting labour's consumption power of what is being produced. Unfortunately, Neoclassicists do not take this fundamental component of their approved system (capitalism) into consideration.

Capital accumulation and crises: In capitalism, the only way capitalists can preserve and enlarge their capital is by way of accumulation, which is usually enhanced by increase in exploitation. Karl Marx gave a detailed account of how the accumulation process will be interrupted and thus, come to a halt, and crisis will inevitably set in and remain permanently in the capitalist system. He held that the expansion of production will later lost its necessary correlation with the profitability of capital, thereby leading to overproduction, relative to the 'needs' with the capacity to pay. Overproduction, because supply will exceed demand (since workers have limited purchasing power) and thus pave way for reduction and later, extinction of profit for capitalists. To further explain the capital accumulation process and crisis, Marx said that capitalists get profits from exploiting labour, that is, by forcing workers to work longer than they should. The capitalists invest the profit (surplus value) in more capital machines, equipment etc. The resulting cumulative technological developments will expand business, thereby leading to demand for more labour, increase in productivity as well as expanded production. However, the increase in the demand for labour pushes up the wage rate and the capitalist will replace some of the *'high-waged'* workers by buying more labour-saving capital. But to Marx, surplus value (profit) comes only from labour. Therefore, as labour demand declines, surplus value falls. With this, capitalists will try to cut costs by introducing more labour-saving equipment, which makes matters worse. Why? Because the increase in labour-saving machinery and the growth of big businesses will lead to both absolute and relative impoverishment of the workers. Absolute impoverishment will be evidenced in the fact that the standard of living will fall. Relative impoverishment means that even if standard of living remains stationary or rises, the percentage share of the new value produced, that the workers receive, declines, and workers will grow poorer, relative to capitalists. With the growing 'misery, oppression, slavery, deregulation and exploitation of the workers, their will to revolt (and possess their possession) also grows. The knell of capitalist private property sounds and the expropriators are expropriated (Oser and Blanchfield, 1975:185). Marx also went on to postulate that:

> … with the capitalist production, an altogether new force comes into play – the credit system. In the beginnings, the credit system sneaks in as a modest helper of accumulation and draws by invisible threads, the money resources scattered all over,... But soon, it becomes a new andformidable weapon in the competitive struggle and finally, it transforms itself into an immense social mechanism for thecentralization of capital" (Oser and Blanchfield, 1975).

According to Marx, crises are, therefore, inevitable in the capitalist system and there will be one crisis after the other until there emerge a concentration of capital as well as ownership of almost all means of production in few hands.

THE CURRENT GLOBAL ECONOMIC CRISIS

The present global financial crisis started as just a case of few misplaced housing loans. It all started in the United States in August, 2007 and could be traced to the collapse of the housing market and the high default experienced in sub-prime mortgages. A couple of years back, financial institutions (being carried away by greed) violated the fundamental law of lending - (which states, "never lend money to someone who cannot repay it") and went into '*sub-prime mortgage lending*'. The borrowers had been borrowing and paying back and so, it was assumed that they will always pay back whatever was being borrowed. As a result, loans were given without proper credit checks or down payment. Everyone (the borrower and the financial institutions) was happy. There was money all over, but little did the financial institutions know that such greed on their own parts would turn into a financial *mayhem*, which would ruin their own *'backyards'*, obtain massive proportions, degenerate into chaotic panic, and take its toll on the global economy. In March, 2007, sub-prime mortgages went as high as $103 trillion in the United States and by June, 2008, about 25% of it turned out to be bad loans.

The resulting effect was a credit squeeze which has ravaged, not only the U.S. economy but has also engulfed the entire globe today. Evidences are in loss of jobs, less than full employment output, bankruptcy, failing financial institutions, stock markets crash, as well as economic recession. Presently, the world is in a form of networked recession which is triggered by the combination of three factors; the crisis in the financial market, the collapse of the housing markets and the decline in equity market.Many believe that the root cause of the current global economic crisis is the adoption of Neoliberalism promulgated in the Washington Consensus as the new orthodoxy, following the dwindling of the dominance of Keynesian Economics in 1979 (Williamson, 2004). According to the Neoliberal thinking, economies are in crisis because of impediments to the free operations of the market.The solution, according to this thinking, is the withdrawal of the 'state' from the economy and the reinstatement of the unhindered operation of the market (Mavroudeas and Papadatos, 2005). Neoliberalism further propagates that the operations of the financial system should be liberated from the state grip and prerogatives and be left to the free operation of market forces.

The Neo-liberalists tow the Classical and Neoclassical line, by prohibiting government intervention in the entire markets. But the current economic meltdown or crisis is traced to have been caused by excessive greed and speculation (of capitalists), and the virtual absence of a meaningful regulatory intervention in the capitalist mode of production (which is the dominant economic system in today's world). This has gone to prove that the free market economy does not have sufficient mechanism to self-correct itself and hence, the current crisis has again questioned the much-trumpeted efficiency of neoclassicism and all its '*descendants*'.

Marx's prediction in the current global economic crisis: In linking the current global economic crisis with our knowledge of History of Economic Thought, we can rightly submit that the current crisis compares with Marx's prediction of economic crisis in the capitalist system. The dominant economic system in the world today is capitalism and Marx had provided a good account of today's financial implosion by saying that:

> "to the possessor of money capital, the process of production appears merely as an unavoidable intermediate link, as a necessary evil for the sake of money making. All nations with a capitalist mode of production are therefore seized periodically by a feverish attempt to make money without the intervention of the process of production" (Oser and Blanchfield, 1975).

Yes, the 'feverish attempt to make money' has resulted in the current failure in the stock and credit markets. When man finds himself in activities that can generate money, he is capable of excesses and abuses if not adequately supervised and monitored. As predicted by Marx, the entire system (capitalist system) has been exploited by the elites at the expense of the middle class. There has been serious exploitation of labour within the capitalist business circle. Wealth has only been concentrated in the hands of very few people. Capitalism has allowed for the creation and distribution of wealth and resources with emphasis on the amount of profit desirable for the individual entrepreneurs. It is worth noting that, unfortunately, surplus (profit) was existing in a system that had been overtaken by greed. In an attempt to satisfy this greed, the only resort was to place the surpluses in the financial market (which was very juicy - especially without proper regulation). The operators of the financial market embraced their patronisers with open arms as they were carried away by the profits each deal generated. Due diligence was thrown to the air and risk was taken in excess. The capitalist system has constituted a serious failure, and as submitted by Stiglitz (2008) at the United Nations General Assembly Panel Discussions, "the underlying doctrine of the current system is flawed and has been the root cause of the current global economic crisis".

Since Marx's prediction of crises in the capitalist system, three major economic crises have taken place in the world. These are; the crisis of 1830's, the great

depression of 1930s, and the 2008 global economic and financial crisis. Marx's prediction that is yet to manifest is the masses revolution. This, of course, has not been, because the masses have resorted to lip services, just to gain favour from the capitalists.

The current global economic crisis and the resurgence of Keynesian economics: From our analysis so far, there is no gain saying that the current global economic and financial crisis has shaken the walls of the free market consensus. It is obvious that the Classical, Neoclassical, New Classical, as well as the Neoliberal schools' postulations have failed again. Keynesianism is now more relevant, as several countries including the United States, have embarked on direct government intervention through massive *stimulus plans* in order to rescue the financial and the real sectors of the economy. For instance, Barrack Obama's Stimulus Package of $878 billion (approved by the government in February, 2009) represents the biggest fiscal stimulus ever. This is to be invested in public infrastructure to generate jobs and economic activities (Sampson, 2008; Osunkeye, 2009). China had also enacted a $586 billion infrastructure packages and has already begun this massive government spending program, to compensate for the sharp decline in aggregate demand. United Kingdom is not left out as it has also adopted fiscal stimulus in efforts to rescue its economy from the grip of the global crisis. This is evidenced in the launching of $47 billion economic stimulus package to boost production and consumer spending and exchange. In November, 2008, the European Commission proposed a $200 billion stimulus package to create employment, boost spending and fast-track growth in the region (Sampson, 2009). Several European Union Member Countries have announced their own stimulus packages. France has launched a £26 billion (about $35 billion) package with about £11 billion of it set to be spent on businesses and £4 billion on infrastructure and public service. Japan, the world's second leading economy has also announced series of bail out measures since inception of the current crisis. The latest being the 10 trillion yen ($100 billion) fiscal stimulus announced in April 5, 2009. Afro-Asian economies are not left out as they have also taken stimulus steps. India, for example, unveiled a $4 billion stimulus package last December. South Korea followed suit with their $11 billion fiscal stimulus plan.

The historical proof of government intervention in the economy as argued by Essien (2010) and Akpakpan (2009) justifies the above governments' actions. Following the economic depression of the 1930s, the American President, Franklin Roosevelt, introduced a package of policies described as "The New Deal" to promote economic recovery. The New Deal included price stabilization through National Recovery Administration (NRA), extension of the collective bargaining through the Wagner Act, provision of the Security and Exchange Commission(SEC), social security including the creation of Aid to Families with Dependent Children(AFDC),etc.

The current responses of governments (across the globe) to the global recession fully recognize the Keynesian view that the market does not have any automatic mechanism to self-correct itself, and that government intervention is necessary to revive the economy. Keynes aggregate demand management has once again become a critical policy instrument for both developed and developing economies. However, as Keynes himself agreed, in the long run, the market forces will drive the economy into equilibrium, if the government takes appropriate actions to correct the short run fluctuations through appropriate macroeconomic policies.

CONCLUSION

The current global economic and financial crisis is a repetition of history and a product of economic thought. It is an indication that a system (the conventional system which is the neoclassical self-regulating market system) does not have adequate potency. Some people like David Ricardo, Thomas Malthus and Karl Marx foresaw it and reacted differently. For us, the divisions (by various Economic Schools of Thought) are really unnecessary as none is entirely correct and none is entirely wrong. Yes, they have helped in making us understand our system and we can tap from each school and fashion out something for ourselves. If greed and speculations are minimized, and adequate levels of regulatory measures are instituted, price will still remain the best signal in resource allocation income redistribution. With economic policies based on Keynesian principles of demand management, capitalism will survive more business cycles to come. Therefore, there should be a fair balance of government and private enterprises, and for the Less Developed Countries (LDCs), the complexion of government should be such that it is sensible, benevolent and development-oriented.

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