

DIFFERENCES BETWEEN A NORMAL AND A GREAT CRISIS* **(a comparison between the one in 1929 and the current one in 2007)**

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Abstract: The crises witnessed by capitalistic economies may be distinguished into two categories, according to the intensity, the duration and the extent of the disasters caused by them. In what concerns the first category, the normal or current crisis, it is referred to the cyclical fluctuations which are an inherent characteristic of capitalism, fluctuations of private initiative determined by the degree of confidence investors have in the future, that determine, in turn, the intensity of economic activity. It is here that we find the undue excitement and over optimism on the part of investors who are willing to undertake extreme risks, because they tend to overrate future returns on their investments. The current crisis we are facing belongs to the category of *great* ones and is the second one witnessed by mankind in the last eighty years. The article also presents several similarities between the current crisis and the 1929 crisis, such as the moral crisis (characterized by extreme individualism, the pursuit of maximum profit and greed), sky-high remunerations of the *golden boys*- the managers and bosses of the financial sector – then and now, or the shift towards right or extreme right wing parties, in both cases.

Key words: current crisis, great crisis, capitalistic economies, the 1929 crisis, duplicated sufferance

a) Normal or current crisis

Cyclical fluctuations are an inherent and therefore natural characteristic of capitalism. They are mainly due to the nature of investment expenditure which is volatile, unpredictable and not easily affected by relevant economic policy measures. This volatility is due to the factors determining investment decisions. In capitalistic economies the latter are taken individually by entrepreneurs trying to minimize the danger related to them. This is the reason why before embarking on a new investment, entrepreneurs attempt to predict the demand and prices related to their products, the interest rate¹, the wage level, the tax rates, the stability of the economy in which they operate. Before any investment decision, there is an attempt to predict future indicators which on one hand determine the cost of the investment and on the other hand its return. The result of comparing the cost and return of an investment leads to the *marginal capital return*² and only if the latter is considered to be satisfactory will the entrepreneur decide to undertake the investment. However, the perception of entrepreneurs concerning the extent of possible dangers and the expected profit related to a specific investment is rarely based on objective criteria. The reason is that the psychological state of investors is subject to often unfounded enthusiasms and unjustifiable disappointments which lead to constant pitches in economic activity.

The economy always finds itself on either an upward or downward phase of an imaginary cycle but its activity never follows a straight line. In the upward phase, all the main economic indicators follow an upward path while, during the downward phase a corresponding downward one. Attempting to interpret these fluctuations resulted in the emergence of numerous theories. The prevailing theory however, is the one formulated by J. M. Keynes in his *General Theory on Employment, Interest and Money* which focuses on investors' expectations as to the return on their investments. According to this theory, shifts in economic activity originate in shifts in the psychological state of investors who are inordinately affected by optimistic as

¹ Which should be expected to be lower than investment rate of return

² This is the expected return of an investment. It should be at least equal to the corresponding interest rate.

well as pessimistic perspectives. In any case, the true causes as to when and why the economy passes from the upward to the downward phase of the cycle are rather unclear, especially in the case of really acute crises.

The advent of the crisis is laid out by behaviors during the last stages of the upward phase. These stages are characterized by undue excitement and over optimism on the part of investors who are willing to undertake extreme risks, because they tend to overrate future returns on their investments. As a consequence, they refuse to take into account the unsettling signals already emitted by the economy, more specifically referring to an overabundance of mainly production goods, an increasing rate of production expenditure and an increasing interest rate. Overabundance is the result of overinvestment in previous years, combined with a relative satiation of needs, increasing production expenditure is due to the fact that the economy is approaching or has already achieved full employment, while an increasing interest rate reflects a rising demand for money, as well as the speculative trends inherent in the upward phase. Predicaments are accentuated because a drop in investment goes hand by hand with a restriction of consumption and a decrease in the general price level. In turn, decreasing total demand leads to increasing underemployment and unemployment. Pessimistic forecasts as to marginal capital return are enhanced and lead the economy into the downward phase of the cycle which comprises crisis and depression. All main economic indicators follow a downhill trend during this phase³. Fear, disappointment and insecurity concerning the future discourage risk taking, which goes hand by hand with any investment and minimize or even eliminate marginal capital return. This is followed by a sudden acute preference of individuals for liquidity. The significant increase of the demand for money raises its price, that is the interest level, and at the same time leads to a further decrease of marginal capital return. The cycle begins once more when, approaching the end of the downward phase, optimistic expectations are gradually restored again, enhancing marginal capital return under the impact of the exhaustion of stocks, increasing price level, increasing entrepreneurial profit and increasing workers' remuneration. The economy now enters the upward phase of the cycle.

In capitalism therefore, fluctuations of private initiative which are determined by the degree of confidence investors have in the future, determine in turn the intensity of economic activity. Exactly because the existence or nonexistence of confidence depends to a large extent on volatile factors, monetary and fiscal policy measures aiming at having an impact on it, stumble on serious and sometimes insurmountable difficulties.

In spite of the unfortunate effects of the downward phase of the cycle on the quality of life of individuals, the latter is nonetheless viewed as an unavoidable and therefore expected phenomenon. Its advent does not have truly disastrous consequences and in case implies no institutional changes.

b) Great crisis

This is by no means the case of crises which could be characterized as *great*. The current crisis definitely belongs to the category of *great* ones and is the second one witnessed by mankind in the last eighty years.

Exactly because these –for the time being - rare crises are different in many aspects from the *cyclical or current* ones, their interpretation requires the addition of extraordinary causes to the well known ones which are responsible for the *cyclical or current* ones. The need for such an interpretation necessarily takes us back to the

³ The demand for consumption, the general price level, entrepreneurial profit, workers' remuneration and investment.

great depression of 1929-1933, as long as it was the only painful experience of such a great crisis until 2007. Its consequences which persisted up to the end of World War II were altogether tragic. It is enough to mention that the 1933 GDP was by one third lower than the corresponding one of 1929, one out of four workers, or in other words, 25% of the US labor force was unemployed, many people witnessed famine or were afraid that they might⁴. The most problematic phase of the economic cycle which is there to stay, in the case of the *great crises*, is depression. Apart from its long duration which, in the 1929-1933 crisis is estimated at approximately ten years, we should also stress that economic science possesses of no satisfactory answers either as to the causes responsible for it or as to the measures necessary to deal with it. However, the eventual simultaneous existence of depression and disinflation, or in other words the long term downhill trend of the general price level, could interpret a large part of its consequences.

1. *Similarities between the two great crises*⁵

It is too soon to arrive at fool-proof conclusions concerning the crisis we are witnessing. Relevant estimations which mainly concern its consequences⁶, present it as being just as disastrous as its predecessor by eighty years, while as time goes by, there are increasing predictions that it might result in even more tragic consequences.

Among the analysts of the present crisis, some support that there are no similarities with the 1929-1933 one, while others insist on the existence of such. On my part, and as already mentioned above, I believe that the similarities between these two murderous crises are become absolutely clear if related to the system prevailing in both cases before their emergence, known either as *laissez-faire*, *laissez passer*, or as *new liberalism*⁷. There are obviously important differences between them, which is to be expected if one takes into account the time span between the two, as well as the radical changes which occurred within the general socio-economic and technical environment during this time period. Most important however are their impressive similarities, revealed in the analysis of the socioeconomic circumstances prevailing before the eruption of the two *murderous crises*, in 1929 and 2007 accordingly. I believe that this similarity is what can support a causality hypothesis between these two factors, namely the socioeconomic environment and the emergence of crises whose intensity surpasses the limits of cyclical fluctuations. This is why I shall proceed to summarize within

⁴ See John Kenneth Galbraith (2000), *The Great Crash of 1929*, (in Greek), chapter 9, Nea Sinora –A. Livanis.

⁵ Extracts from the similarities between the two *murderous crises* have already been included in the following articles published by the author : - “Criminal new liberalism and the current crisis”, *Komotini Paratiritis*, 18/10/2008 (in greek). - “Criminal new liberalism and the current crisis”, *Politiki Enimerosi*, October 2008(in greek). –*Du liberalism au neoliberalisme en matiere economique*”, *Conference aux etudiants de l’ Universite “Valahia” de Targoviste, dans le cadre de la premiere rencontre du Club des DHC, Targoviste, Octobre 2008, pp. 1-19(in French)*. *Similarities between the current crisis and the great crisis of 1929-1933 have also been noted by Jaques Attali in the case of France, since 2007.*

⁶ Relevant comparisons between the current crisis and the great crisis of 1929-1933 mainly focus on an effort to predict the extent of its consequences, while lacking entirely, in my opinion, of an analysis of its causes, while there lies all interest as to their similarities.

⁷ With all reservations imposed by comparing the consequences of these two systems or ragbags which may be justified by the numerous ambiguities related to any attempt at defining and specifying the meaning of *new liberalism*.

the frame of the present introduction certain similarities between these two great crises, which I believe to be significant.

A system very similar to what is known as *new liberalism* nowadays was adopted in the 19th century and its consequences, as summarized by the analysts of the time, were as disastrous as those witnessed today by mankind, picking up in intensity since the mid '80s⁸.

The main idea is the glorification of profit, irrespectively of the methods by which it is pursued, the effort to minimize wages and dissociate them from labor productivity, the enmity towards state intervention in the economy, the encouragement of extreme individualism which intensifies corruption, the degrading and gradual abolition of the rights of workers, the progressive social pauperization and exclusion of a growing social group from the fruits of progress, the elimination of the middle class, the large scale employment of children under 8 years, the all the more frequent and intense eruption of all kinds of crises.

The source of all these crises however, is the abolition of all market regulations and the toleration of unrestrained speculation worldwide.

In the beginning of the 19th century, pauperization of the working class had reached a climax and was solely due to *extreme new liberalism* prevailing then, as well as now. The following description of that era could very well refer to today. In short, the prevailing conditions could be described as follows:

“Competition among entrepreneurs in the market of goods does not allow the improvement of wages. There is also competition in the labor market, where workers address entrepreneurs individually and with no organization. The working class is paying the price of the competition on which the system is based”⁹.

But the pursuit of profit in any way and with any sacrifice in the 19th century – as well as in the 20th and 21st century – degrades morality and all fundamental values of life. This moral crisis which is kindled by extreme individualism, the pursuit of maximum profit and greed, was described in reference to that period – but could very well refer to the present day- by the well known economist Francois Perroux, as follows¹⁰:

“When the civil servant, the soldier, the judge, the priest, the artist, the intellectual is possessed by this spirit – to become rich, to pursue maximum profit -, society crumbles and the economy as a whole is threatened”.

Another impressive similarity between the current crisis and the great crisis of 1929, consists of the sky-high remunerations of the *golden boys*- the managers and bosses of the financial sector – then and now. There is a lot of discussion on these, mainly because of the anger expressed by the public which correctly believes that they are largely responsible for the crisis. These remunerations were extremely high around 1929 and then again from the mid '90s to 2006¹¹. The common justification is that investments – or rather speculation- realized in the financial field present high risks due to innovations whose consequences are still uncertain, so that high remuneration is necessary for those undertaking such extreme risks.

⁸ See J. Marshal (1957), Cours d' Economie Politique, 3eme edition, chapter III, éditions Genin, Paris.

⁹ Ibidem, p. 104

¹⁰ *Le Capitalisme*, p. 105

¹¹ See F. Norris (2009), “In finance, wages are due for a fall”, *International Herald Tribune*, 23/1.

Still another similarity worth mentioning between the 1929 crisis and the current one, is the shift towards right or extreme right wing parties, in both cases.

The regrettable consequences of enforcing in the 19th century the system which we are suffering again since the '80s, caused severe reactions which paved the way for its transformation. Such a transformation is certainly the emergence of an ideology which was exactly the opposite of that advanced by the classical A. Smith, in the face of K. Marx's *Capital*, in 1867 as well as J.M. Keynes' *General Theory* in 1936. As we know, J.M. Keynes introduces state intervention in the economy, in an attempt to save the capitalistic system which seemed unable to continue operating as before due to its exaggerations. Thus, extreme liberalism whose adoption is considered to be the cause behind the great depression of 1929-1933, as well as World War II, was abandoned after the war, in favor of a mixed system. The latter is still based on individual initiative but is complemented and regulated by state intervention.

Thanks to this co-action of individual initiative and the state, Europe – and not only- witnessed the highest growth rates in its history, combined with more equitable income distribution and greater social cohesion. This period also allowed for the development of the welfare state. During the same time, Europe managed to create its own unique form of capitalism, known as capitalism with a human face, for which it justifiably was extremely proud.

The 20th century consolidates the rights of workers, in the aim of reinforcing as much as possible, the worker's side in labor market negotiations, as long as lacking such support, the worker is at a disadvantage and can very easily become the prey of employers, thus paving the way for all kinds of exploitation. This is how social Europe was born.

While all of the above was taking place on the international scene, new liberalists were impatiently waiting for opportunities through which they could once more impose their fanatical ideologies on mankind. And these opportunities did come, they were plenty, mutually complementary and complex.

Indeed, this reversal of mankind through the adoption of an archaic scheme, was significantly aided by the advance of *globalization*, which was initially imposed by the US and was then extended to the whole world. *Globalization* was established together with the new stage of capitalistic evolution, namely the stage of new technologies or information technology or services or the immaterial stage of development. The beginning of this new development stage coincided with the collapse of the socialist system. The familiar, to economists, ideas of Friedrich Hayek¹² and nobelist Milton Friedman¹³, true proponent of the first, on the advantages of the free market, embarked on a persistent confrontation to the Keynesian views of the interventionist state, but with a tendency towards exaggeration.

For the purest new liberalists, the core of their ideology is not so much the imposition of free international trade or the need to balance all accounts both internal and external, or even the belief in the unfailing invisible hand of the market. *On the contrary, the core of the fanatical new liberalist outlook consists of an intense hate towards the state.* Thus, the primary objective of new liberalists, who accept with insufficient

¹² See F. Hayek (1939), *Profits, Interests and Investment and other essays on the theory of industrial fluctuations*, Routledge and Paul Kegan: London.

¹³ See Milton and Rose Friedman (1980), *Free to Choose*, Harcourt Brace Jovanovich.

evidence and no exceptions the absolute supremacy and ex ante greater efficiency of the private sector consists of the minimization, deactivation and neutralization of the role of the state in the economy.

However, there never has been and there never will be a neutral state, because the state has always played an important role in the economy. The problem is to be found elsewhere, namely as to whether interventionist state policy benefits those who are in need or, on the contrary, the apparent inaction of the state is detrimental to them. Neutrality, that is non-intervention of the state, has indeed proven to be the strongest political alibi in the aim of favoring the powerful and pauperizing the needy.

The disastrous consequences of new liberalism in all sectors of the economy and all aspects of society, as well as the absolute withdrawal of all moral values, led to its breakdown as in 2007, the world economy entered the second murderous crisis in its history.

Back in 1929 as in 2007, the realization of the emergence of this second great economic crisis rapidly leads to a countdown, in the specific form of:

- A race for nationalizations¹⁴,
- An invasion of state intervention in the economy through large public projects,
- Announcement of strict regulation of the banking sector,
- Massive takeovers and nationalization of banks,
- Recourse to uncontrollable public deficits,
- Reversal to protectionist measures.

Thus, in the Davos summit of 2009, occurred something which would appear unbelievable a few months before. There is talk of *state capitalism*. This full scale reversal betrays a shortcoming of economic policy which seems unable to follow the *golden mean* but on the contrary, especially in turbulent times has the tendency of violently shifting from one extremity, which could be characterized as *predatory capitalism* to another which among others is currently *state capitalism*. It goes without saying that the characteristics of *state capitalism* containing significant elements of exaggeration and panic, do not portray in any sense the views of J.M Keynes who was definitely a proponent of a rapport, cooperation and interrelation between the public and the private sector.

To sum up the similarities between the two most important crises in history, the 1929 one and the 2007 one, I consider extremely interesting the answers given to the following question within the frame of a CNN research project in the USA: “Do you believe that the sufferance of 1929 could be duplicated?” – after the conditions then prevailing had been described. About 60% of those asked gave a positive answer!¹⁵

¹⁴ On the debate between private and public firms see M. Negrepointi-Delivanis, *Private and Public Firms*, Sakkoulas, Thessaloniki, 1993 (in greek).

¹⁵ “The curious capitalist- Justin Fox”, *Time*, 22/12/2008