THE GLOBAL ECONOMIC CRISIS

INTRODUCTION

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This book contains the proceedings of the conference *The Global Crisis: Contributions to the Critique of Economic Theory and Policy*, held at the Economics Faculty of the University of Siena, Italy on the 26th and 27th January 2010 with the participation of some of the leading Italian figures in the critical approach to mainstream economic theory.[1] The speakers, authors, discussants and chairs of sessions comprised Roberto Artoni, Aldo Barba, Enrico Bellino, Riccardo Bellofiore, Bruno Bosco, Luigi Bosco, Emiliano Brancaccio, Duccio Cavalieri, Roberto Ciccone, Lilia Costabile, Giuseppe Fontana, Guglielmo Forges Davanzati, Giorgio Gattei, Joseph Halevi, Andrea Imperia, Stefano Lucarelli, Vincenzo Maffeo, Ferruccio Marzano, Marco Musella, Ugo Pagano, Marco Passarella, Stefano Perri, Fabio Petri, Antonella Picchio, Massimo Pivetti, Andrea Presbitero, Riccardo Realfonzo, Maria Alessandra Rossi, Neri Salvadori, Ernesto Screpanti, Anna Soci, Antonella Stirati, Guido Tortorella Esposito, Alessandro Vercelli, Alberto Zazzaro and Gennaro Zezza. The conference program also included a paper by Sergio Cesaratto, who was unable to attend.

The conference constituted an important opportunity to gather together and to examine some of the major heterodox interpretations of the global crisis that broke out in the summer 2007 and turned into a deep recession in 2008. In more general terms, it offered new stimuli to update and revitalise criticisms of the so-called “mainstream” economic theory and policy. At this stage, it may help to say few words about the concept of mainstream and its critique. The current mainstream is represented by the dominant “imperfectionist” approach to neoclassical economic theory. The advocates of this line of research accept the neoclassical framework of neo-Walrasian analysis but admit deviations from its competitive equilibrium on the grounds that it is necessary to take the imperfections, asymmetries and rigidities usually characterising economic reality into account. The present-day mainstream includes the analyses derived from an evolution of the old Neoclassical Synthesis and generally described as New Keynesian or New Consensus models.[2] On the other side, the expression “critique of economic theory” has a long heritage in the history of economic though. It appeared meaningfully in the subtitle of Piero Sraffa’s celebrated *Production of Commodities by Means of Commodities*, which in turn echoed the “critique of political economy” in the subtitle of Marx’s *Capital*. Today the term can be referred in some respects to a range of different schools of thought. These include not only the studies of direct Marxist and Sraffian ancestry but also those developed in Post-Keynesian, Kaleckian, Circuitist, heterodox Institutionalist and other circles. Although these schools of thought differ in several methodological and theoretical respects, they share the common theme of the critique to methodological individualism and to the neoclassical paradigm of "scarcity".[3]

At the time of writing, the principal research centres are torn between expectations of a tangible recovery making it possible to announce the end of the great recession, and fears that the world may plummet once again into the abyss of a systemic crisis. The reasons for this uncertainty include the fact that the root causes of the crisis appear in many respects to be still shrouded in mystery. The media give currency to the idea that economists are unanimous in considering the permissive financial legislation of recent years as a decisive factor in triggering the crisis. The truth is, however, that this interpretation, though largely accepted, is regarded as wholly insufficient to account for a collapse of such vast proportions. Moreover, as it becomes immediately apparent on probing beneath the superficial media coverage of the debate to a deeper level of analysis, economists disagree with one another so radically that it is hard to identify any one explanation of the crisis as prevailing over the others. The disarray within the mainstream literature is emblematic in this respect. On the one hand, we have the interpretation exemplified by John Taylor (2009), which sees the collapse of 2008-2009 as the result of an excess of money in circulation due to the expansionary policy of the Federal Reserve in US. On the other, Alan Greenspan (2009, 2010) and others identify the cause of the current crisis in a global "excess of saving" caused above all by China's determination to spend little and firmly maintain its position as creditor with respect to the rest of the world. Despite their shared theoretical roots, these two views have conflicting political implications, with the blame for the crisis being laid respectively at the doors of American and Chinese economic policy. A variant of these theses points not only to the problems deriving from very low interest rates or excessive global savings, but also to the unrestrained use of "leverage", i.e. buying financial assets on credit, made possible by banking deregulation.[4] The divisions between orthodox economists do not end here, however. Various more or less openly avowed "heretics" can also be glimpsed in the ranks of the mainstream, especially Fitoussi and Stiglitz, who have even taken up one of the heterodox thesis that the cause of the current crisis is due to a decrease in workers' consumption caused in turn by the great inequality of incomes established over the last thirty years.[5] While this approach presents some elements of unquestionable interest, it could also cause embarrassment among orthodox economists, as it appears scarcely compatible with the logical foundations of mainstream analyses, including the models usually adopted by Fitoussi and Stiglitz themselves.[6] Finally, outside the narrower boundaries of the present mainstream but inside the neoclassical field, some mention should at least be made of the theorists of the Real Business Cycle. Though remaining slightly on the sidelines, these economists have managed to make their presence felt in debate on the crisis through the publication of a controversial manifesto against the expenditure policies of the American federal government.[7]

For the moment at least, it can therefore be asserted that the outbreak of the crisis has given rise to an authentic “neoclassical babel” as regards both theoretical interpretations of the recession and the measures of economic policy suggested as remedies by orthodox economists. A different situation seems to prevail among critics of the dominant economic theory, where an opposite tendency appears, unusually enough, to be gathering momentum. The last few months have in fact seen an exceptional blossoming all over the world of analyses of the crisis developed by Post-Keynesians, Sraffians, heterodox Institutionalists and Marxists. Italy appears in particular to have confirmed its historical vocation as a forum for contributions from different schools of critical thought. In this sense, the proceedings of *The Global Crisis* conference in Siena offer a broad overview of the heterodox Italian studies of the crisis that began in the summer of 2007 and the related recession of 2008-2009. It is interesting to note that these analyses appear in various respects to converge on a common interpretation of the crisis. Its nucleus can perhaps be pinpointed in the shared objective of putting forward an updated version of the idea that the process of capitalist accumulation leads to a growing contradiction between the development of productive forces and the restricted consumption of the working masses.[8] Many of the studies contained in this volume address the possibility of efforts having been made for a long time to cope with this contradiction through autonomous expenditure financed by increasingly accentuated processes of private indebtedness. The resulting interpretation of the crisis developed in the papers presented in Siena can be outlined as follows. The last thirty years have seen major changes in the international structure of the capitalist relations of production, with the intense concentration of capital on the one hand, and the fragmentation of labour on the other. These phenomena have led to a broadening of the world-wide gap between the increasing productive capacity of workers and their stagnant or even diminishing purchasing power. In principle, the widening of this gap should have caused the world system to slide towards crisis. This did not happen immediately, however, as depression appears to have been averted for a long time through repeated injections of autonomous expenditure stemming above all from the boom of financial and real estate values, and especially the continual speculative ups and downs of Wall Street. In other words, the contraction of wages and social expenditure, and hence of private and collective consumption on the part of workers, was balanced by two phenomena. First, there was an increase in the expenditure of those possessing financial capital. Second, workers were able to maintain some purchasing power via new borrowing opportunities in part caused by the rise in the value of financial and real estate assets. The effective demand was then supported by the expenditures of a heterogeneous group of actors: “masters” of Wall Street, executives of companies, and even those who might be called “ultra-speculative” working poor. Being directed mainly to the purchase of consumer goods or real estates, these expenditures did not generate additional productive capacity but did help to reduce the gap between capacity and demand. American finance was unquestionably the driving force of this mechanism, and the U.S. dollar its means of propagation. The performance of Wall Street and the trend of dollar exchange rate triggered the formation of the major speculative bubbles of recent years and allowed the United States to finance an unprecedented increase in imports from other countries. In this way, America gradually turned into a sort of “sponge” absorbing much of the productive capacity of the rest of the world, acting de facto as the overall driving force of the economic system. Accumulation of this type cannot last indefinitely, however. In order to compensate for the widening gap between the development of productive forces and the restricted consumption of the masses, it is in fact necessary for financial values to increase all the time so as to counter the stagnation of the incomes of the indebted workers and the greater propensity to save of shareholders. A financial boom can, however, last over time only if the speculative bubble is fuelled by increasingly close and accentuated relations of credit and debt. The system is thus on a rope ladder stretched over a chasm and bound to give way as soon as there is any loss of confidence in the continuation of the financial boom. Some of the studies presented in Siena suggest that the expansion reached its limit when the contradiction of workers’ stagnant wages and increasing debt became unsustainable. While it is difficult to identify the ultimate causes of the turning point of a speculative phenomenon, this explanation does find a certain amount of theoretical and empirical support, and therefore deserves to be taken into careful consideration.

As readers will see, the sixteen papers gathered together here make it possible to examine each of the aspects of the crisis mentioned above. The book is divided into four Parts, namely (I) The Crisis of Economic Theory, (II) Labour, Distribution and Profit Trends, (III) International Economic Relations, and (IV) The Theory of Economic Policy. Part I contains contributions by Brancaccio, Vercelli, Bellofiore & Halevi and Imperia & Maffeo. In his contribution, **Emiliano Brancaccio** challenges the belief that the debate among mainstream economists is sufficient in itself for the development of an adequate interpretation of the global crisis. He maintains that a close analysis of the current debate in mainstream economics reveals some internal contradictions. For example, some authoritative orthodox economists have put forward an explanation of the crisis focusing attention on the depression-inducing effect of the inequality of incomes, a phenomenon that appears somewhat hard to incorporate into the typical mainstream models. The author argue that an alternative and consistent interpretation of accumulation and the capitalist crisis could then be found in the critical literature, with particular reference to some recent studies around the concept of “monetary reproduction”. However, in the area of economic policy the critical approaches do not yet seem really innovative. An example of backwardness is the difficulty of recovering and updating the crucial theme of planning. The contribution of **Alessando Vercelli** is devoted to the interaction existing between the twin crises of the real economy and of economic theory. Through an original re-reading of the development of the economic ideas and policies of the 20th century, the author identifies a crucial cause of the economic crisis in the incapacity of the dominant theoretical approach to examine phenomena characterised by marked irregularity. A slightly different line is taken by **Riccardo Bellofiore and Joseph Halevi**, who argue that we are now going through a third crisis of economic theory that appears to have taken not only mainstream theory but also several heterodox approaches by surprise. In their view, the characteristics of the present crisis rule out any reading focused on the problem of distribution alone and require rather a new look at the work of the authors who perceived the role of debt and the exhaustion of

Keynesianism back in the 1970s, primarily the work of Magdoff-Sweezy and Minsky. **Andrea Imperia and Vincenzo Maffeo** present a review of research papers on the crisis published in mainstream economic journals with a high impact factor and submitted before summer 2007. The survey demonstrates the substantial absence of mainstream work suggesting the possibility of an economic and financial crisis of the kind that then took place, and thus provides food for thought also as regards the currently prevailing methodologies of assessment for university research.

Issues related to the effects of the process of financialization on labour, income distribution and profit levels are addressed in Part II by Barba & Pivetti, Zezza, Stirati, Forges Davanzati & Realfonzo and Perri. The paper of **Aldo Barba and Massimo Pivetti** constitutes the development of a paper foreshadowing some crucial aspects of the crisis, that was submitted to the *Cambridge Journal of Economics* early in 2007.[9] The authors trace the origin of the recession back to wage stagnation and the related attempt of American families to maintain their consumption through increased borrowing, a form of conduct that is unsustainable in the long run and which therefore led to the financial collapse. The analysis thus presents an essentially real explanation of the nature of the crisis as caused by the inequality of incomes and related stagnation of wages, with "financial disorder" seen as a later effect rather than a primary cause of the recession. The contribution of **Gennaro Zezza** also identifies the roots of the crisis in the increased inequality registered in the United States and the associated growth of private indebtedness in order to maintain consumption. The author tests this interpretation using the stock-flow macroeconomic model of the Levy Institute, which has been credited by many as a particularly effective tool in predicting the salient characteristics of the recession that began in 2008. **Antonella Stirati** examines the distribution of income with particular reference to trends in Italy and the major European countries, and finds a decrease in wages in all cases. The explanation put forward is that the earlier fixed exchange rates and subsequent monetary unification reduced the growth margins of wages in industry, the key sector in wage negotiations. Other possible factors are identified in the rates of variation in employment and unemployment and the growth rate of productivity. The results of this analysis highlight an interdependence between income distribution and unemployment that is interpreted in the light both of the Keynesian connection between inequality of incomes, low effective demand and high unemployment, and of the classical-Marxian relation between high unemployment and a reduction in the bargaining power of workers. **Guglielmo Forges Davanzati and Riccardo Realfonzo** develop an interpretation of the crisis based on a particular version of the monetary theory models of production. The analysis highlights the contradiction inherent in the fact that the capitalist reproduction system requires low wages and high consumption at the same time. Consumer credit only apparently resolves this contradiction, as it generates instability of the system as a whole. **Stefano Perri**'s contribution constitutes a new interpretation of the Marxian law of a tendency for the rate of profit to fall. The author interprets the OECD figures for output per unit of capital in the light of a particular reading of the Marxian law, which proves compatible among other things with the typical Sraffian systems of prices. Resolving an old conflict in Marxist debate, the work shows that in given conditions there is a complementary relation between explanations of the capitalist crisis in terms of a tendency of the profit rate to decrease, and explanations based on the widening gap between productive capacity and the restricted consumption of workers.

The crucial theme of international economic relations is analysed in Part III with the papers of Costabile, Screpanti, Presbitero & Zazzaro and Cesaratto. **Lilia Costabile** considers the particular characteristics of the monetary circuit of creation and destruction of the "key currencies" issued by individual countries, but also acting as international means of exchange. The asymmetry between the countries issuing key currencies and all the others is considered a primary source of balance of payments problems, and hence a possible cause of the global crisis. The author sees the thinking behind the Keynes Plan of 1943 as a valid way of resolving the current imbalances of the international monetary system. **Ernesto Screpanti** examines the effects of liberalisation and the global opening of markets on labour conditions and income distribution. Globalisation gave rise to reduced investments in the advanced countries, a shift of income from wages to profits and a resulting stagnation of demand. The different countries reacted to this stagnation in various ways. In particular, the United States opted for a strategy of growth powered by the debt needed to maintain military and financial hegemony, which then gave rise, however, to the present crisis. **Andrea Presbitero and Alberto Zazzaro** examine the effects of the crisis on countries with low and medium levels of income, and focus in particular on the policy of the International Monetary Fund with respect to the same. The analysis reveals that the recent IMF policies of credit allocation still appear to be guided by the strategic interests of the major western powers more than the effective needs of the countries in question in terms of macroeconomic rebalancing. The paper of **Sergio Cesaratto** is devoted to the internal imbalances of the Euro area and their possible interactions with the ongoing global crisis. The major source of European imbalances is identified in Germany's efforts to strengthen its trade surplus. This mercantilist policy is understandable insofar as it is recognised that participation in international trade is primarily governed by the logic of absolute rather than comparative advantages.

The problems of economic policy are discussed in Part IV in the papers of Bosco, Pagano & Rossi and Bellino. **Bruno Bosco** examines the effects of the privatisation of public utilities on income distribution. He argues that these post-1980s policies have also contributed to the shifting of income from workers to shareholders. The author puts forward an estimate of the difference between the performance of privatised public utilities and the average performance of financial markets in Europe as a measure of the income transferred to private investors. **Ugo Pagano and Maria Alessandra Rossi** identify one of the causes of the inequalities and the crisis of this period in the strengthening of the rights of private ownership of knowledge. They show that a shift of ownership of knowledge from the private sphere to the public would trigger a "super-multiplier" mechanism making it possible to combine the traditional expansive effects of Keynesian policies with the propulsive effects of the spread of knowledge understood as a non-rival good. Finally, the paper of **Enrico Bellino** examines two phenomena that have been gathering momentum over the last thirty years, and that many observers identify as the root cause of the present crisis, namely the growth of the profit quota and the "financialisation" of the economy. The dominant economic theory, still based on the Pareto principle, appears unable to supply a convincing normative analysis of these phenomena. The author therefore puts forward an alternative interpretation drawing primarily on Luigi Pasinetti's contributions to the development of a classical-Keynesian normative approach.

The interpretations of the crisis emerging from the Siena conference offer an alternative viewpoint to the one adopted by the mainstream analyses. As readers will see, this alternative is primarily theoretical and based on well-known criticisms, both "internal" and "external", that have long called into question the logical coherence and historical relevance of neoclassical models.[10] The alternative proposed is, however, also empirical in character. The heterodox interpretations of the crisis account in point of fact for two of the most immediately visible world-wide phenomena of the last few decades: on the one hand, the widening gap between the value of labour productivity and direct and indirect wages; on the other, the growth of financial and real estate values with respect to the income produced. Examination of the conference proceedings will show that these phenomena lie at the root of the critical readings of the recession, whereas they may not find an easy accommodation in the corresponding mainstream analyses. Finally, it is interesting to notice that recent criticism of the dominant economic theory also makes it possible to call into question some typical results of mainstream analysis that are usually taken for granted in the literature. Suffice it to mention the famous "Taylor rule" so often cited in the mainstream discussion of the crisis. It is possible to show that this "rule" loses its function of stabilising the economic cycle and inflation within a critical-theory framework and takes on the very different role of guaranteeing the solvency of the system.[11]

The strengths of the heterodox interpretations of the crisis do not, however, constitute as such a guarantee of their influence on the current trends in economic policy. What predominates above all in Europe at the time of writing is a tendency to endorse restrictive policies generating further inequality. Moreover, there still appears to be a widespread desire throughout the world to return to the accumulation of capital through the old mechanism of growth fuelled by American finance. However, the current state of U.S. private accounts raises many doubts on the reactivation of this mechanism. For this reason some observes suggest that the role of the American economy could overturn completely at some point, and that the U.S. could begin to defend the domestic market. Some commentators are then hoping for a boost to world effective demand from a further expansion of China, but in absence of a general reform of international monetary system that country will probably tend to restrain import in order to preserve its trade surplus.[12] Warnings have then been voiced by many about the risk of these conventional approaches to the crisis giving rise to further drops in income and employment. There have also been numerous calls to seek new and different mechanisms to drive economic development and social well-being, first of all by making the global openess of markets conditional to the adoption of "labour standards", reducing income inequalities and proposing a new focus on the public production of collective assets.[13] It is difficult, however, to estimate just how much real notice will be taken of these proposals in the current political debate. It is clear that changes of such scale in the general strategies of economic policy might come about only in case an intensification of the economic crisis leads to deeper transformations in the structure of the social and international relationships.

Last but not least, the organisation of *The Global Crisis* conference in Siena, where the papers collected in this book were first presented, could not have been possible without the help and support of numerous friends and colleagues. We would like to thank Sergio Cesaratto, Roberto Ciccone, Lilia Costabile, Fabio Petri, Riccardo Realfonzo, Ernesto Screpanti, Antonella Stirati and Paolo Cantelli for their advices in the planning and carrying out of *The Global Crisis* conference. While their suggestions may not have been adopted in every instance, they always provided valuable stimuli. We are also most grateful to the Monte dei Paschi di Siena Foundation (Italy) for the financial support of the event, in which connection we wish to thank in particular Paolo Fabbrini, who also delivered a welcoming address at the beginning of the conference, and above all Alberto Faleri and Alessandro Lastray, who shared and supported the fundamental aims of the conference from the very beginning. Our thanks go also to the DASES (Department of Analysis of Economic and Social Systems) of the University of Sannio (Italy), which co-funded the initiative. We also thank Aldighiero Fini, the chairman of Montepaschi Capital Services, for his assistance in putting our plans into operation. We are grateful to Michelangelo Vasta and Francesco Farina, directors of the departments of Political economy, and Economic policy, finance and development, respectively, and to Angelo Riccaboni, Dean of the Faculty of Economics, University of Siena (Italy) for their great hospitality and wonderful assistance. Finally, we thank Carlo Biancalani for helping us to find our bearings in Siena, and Domenico Suppa for his management of the organisational secretariat.

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[1] The provisional proceedings of the Siena conference are available on www.theglobalcrisis.info together with audio and video material and press coverage.

[2] For a rigorous definition of the meaning attributed to the concept of "mainstream" here, see Brancaccio (2011) in this volume. Readers are also referred to Taylor (2000) or to the "core" of contemporary macroeconomics as described by Blanchard (2000). Fontana and Setterfield (2010) offer a basic presentation of the New Consensus Macroeconomics and a critical assessment of it. For a criticism of the New Consensus see also Fontana (2010).

[3] For a possible common denominator between the different contributions to the critique of economic theory see Fontana (2009, part I). For a more stringent definition of "critical theory" based on a proposed combination of the Surplus and Monetary Circuit approaches, see Brancaccio (2008).

[4] See for example Song Shin (2009).

[5] Fitoussi and Stiglitz (2009). See also Fitoussi and Saraceno (2010).

[6] See Brancaccio (2011).

[7] "With all due respect, Mr. President, that is not true", Manifesto of the CATO Institute, *New York Times*, 28 January 2009. Signed by about 250 economists, the manifesto challenged the newly elected president of the United States Barack Obama, who had stated that there would be no disagreement about the immediate need for a plan of government intervention to find a way out of the crisis. The signatories instead expressed their disagreement as regards Obama's plans for intervention. While the economists in question hail from various schools, they include in particular some leading theorists of the Real Business Cycle, including the 2004 Nobel laureate Edward Prescott.

[8] Marx (1894, vol. III, chapter 30) presented an early version of this idea.

[9] Barba and Pivetti (2009).

[10] The "internal" criticisms refer to the problems of logical consistency of the models of neoclassical general equilibrium and their various offshoots, and the "external" to the plausibility and relevance of the primary axioms of the neoclassical theory. See Garegnani (1990), Graziani (2003), Pasinetti (2000) among others.

[11] A provisional version of this critical interpretation of the Taylor rule was presented in Siena by the authors of this introduction. The argument has since been developed in Brancaccio and Fontana (2011).

[12] See also Krugman (2009), who considers the reluctance of Chinese government to spend as a prelude for U.S. protectionism. Krugman points out that in conditions of mass unemployment protectionism can be considered rational by mainstream economic theorists. However, he does not mention the current contradictions in the international monetary system which lead China to preserve its trade surplus. On this subjects see Costabile (2011), in this volume.

[13] See for example the "Economists' Letter" of 14 june 2010 signed by over 200 members of the academic community in Italy and other countries (www.letteradeglieconomisti.it). Similar initiatives have been launched in various other parts of Europe and the world.