WHY THE ECONOMISTS GOT IT WRONG

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The Crisis and Its Cultural Roots

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Introduction

Simplistic reconstructions of the history of thought often point to two contrasting views on the relations between economy and culture. The first, attributed to Karl Marx, has it that the economic structure (or in other words, more or less, power relations in the economic field) determines the cultural superstructure, while the second, attributed to Max Weber, holds on the contrary that it is culture, inclusive of religious opinions and doctrines, which determines the economic and social set-up. As a matter of fact, neither of these two great thinkers ever dreamt of establishing univocal causal relations between economic and cultural variables; economy and culture are also to be seen as two vast and internally differentiated categories. Marx and Weber set out rather to establish the relative importance of one or the other causal relation, and did so in strong terms since each was arguing against widespread opinion to the contrary.

The complex relationship between cultural and economic elements is also to be seen at work in the development of the crisis which hit the world economy. In some instances, strong economic interests favoured one view or the other on how the economy works, as a whole or in some particular aspects. In other instances, mistaken theoretical views favoured adoption of economic policies (including a policy of non-intervention in the spontaneous evolution of the markets) which turned out to be far indeed from optimal.

In the following pages, after briefly illustrating the initial stages of the crisis (Chapters 2–4), its immediate causes and its effects, we shall consider the economic culture underlying the choices which favoured the development of conditions of financial and economic fragility (Chapters 5–9). We shall see in Chapter 5 that, despite frequent assertions to the contrary, a number of economists had foreseen the crisis in that they had drawn attention to factors of financial fragility and systemic instability. After all, this is substantially what is meant when we say that seismologists foresee earthquakes: certainly not by indicating the day and hour in which the earthquake will take place or its magnitude, but rather by indicating the areas of greatest risk, so that the authorities can set strict antiseismic building rules for them. We are thus led to look into the specific characteristics of the theoretical views underlying such analyses. In this respect, Chapter 6 will focus on the notions of risk and uncertainty; in Chapter 7, more generally, we shall compare and contrast the two main approaches to economic analysis: the neoclassical or mainstream one which dominated economic culture in the past decades, and the Keynesian (or, possibly better, classical-Keynesian) one. Subsequently, in Chapter 8 we shall briefly consider some issues in economic policy, mainly relating to the institutional set-up of the international monetary and financial system, from a classical-Keynesian viewpoint. Finally, Chapter 9 is devoted to a few remarks on the theme of the relationship between market and state, all too often conceived, especially in the United States, as an all-out opposition between a communist centralised economy and a *laissez-faire* rule of the market.

In depth and duration the current crisis is closer to the Great Crisis of 1929 than to the repeated, and significant, crises of the past sixty years. Even then the economic crisis developed gradually, reaching its culmination some years after the financial crisis broke out.

Opinions differ on the development of the present crisis. Some commentators display optimism talking of a V-shaped crisis – a sharp fall followed by a quick recovery – with a turning point announced for months as imminent, and now seen as passed over. However other, more pessimistic commentators depict an L-shaped crisis, with the fall followed by a rather long period of stagnation (and with a relatively modest short-run recovery attributed to a strong fiscal stimulus which cannot last long). Still other commentators warily stress the marked variability of financial and economic indicators and the differences between countries and economic areas, thus pointing to the great uncertainty in time and manner of recovery. Finally, a number of economists suggest the possibility of a W-shaped evolution, with short-run recoveries followed by new speculative bubbles and risks of public debt crises (since huge amounts of what was private debt had been transformed into public debt), in the context of a stagnating real economy and renewed perilous plunges in the financial arena. Just as in the case of interpretations of the origins of the crisis and the ensuing debate on policy choices, so these forecasts too are associated with the contending views in the economics debate.

Obviously, many things have changed since the period of the Great Crisis. In particular, experience has taught us something about which policies should be avoided and which adopted. Current accounts in the banks (except very large ones) are in no danger, and queues of clients wanting to withdraw their money have been avoided. Unemployment is growing, but it should be possible to keep it within socially acceptable limits (what a horrible expression!), though social tensions are likely to grow. On the other hand, the changes in the distribution of world economic power are remarkable and international political relations need to adjust to them.

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Policy choices will largely determine how long the crisis will last. The monetary, financial and real policies adopted so far are of proportions never before seen in peacetime. Notwithstanding, the year 2009 closed with a negative growth record in all the developed countries, and with a sharp decline in employment. Moreover, the expansionary policies adopted with remarkable success to prevent catastrophic development of the crisis – the same policies which had frequently been criticized before the crisis as happily forgotten recipes stemming from erroneous economic theories – entail a marked increase in public debt and thus significant risks for monetary and financial stability. It is therefore hard to believe that such policies can be pursued at the present extraordinary levels for more than a couple of years. What will happen when they are abandoned?

The answer we may give largely depends on our understanding of the basic factors leading to the present crisis. According to the optimistic analysts, the crisis may be attributed to certain market excesses and policy errors, but growth may start again almost automatically with no need for big changes in the institutions or the rules of the market economy. It is our contention, however, that the fundamentalist free market attitude, by favouring the tumultuous growth of the financial sector of the economy, has a large share of responsibility in establishing conditions that were conducive to the development of the crisis. Thus, a thorough overhauling of rules and institutions will be necessary if the crisis is not to be followed by a long phase of stagnation, or recovery interrupted by new crises.

The main thesis of the present book is precisely that errors in the dominant economic culture – the so-called Washington consensus – led economic policy to dance blindly on the brink of crisis, and then plunge into it. The myth of an all-powerful invisible hand of the market, the blind faith in automatic equilibrating mechanisms, the hostility to setting rules of the game binding for all participants, the systematic under-evaluation of uncertainty are all, as we shall see, serious mistakes, favoured by their consonance with major economic and financial interests. Such mistakes had already been pointed out through heterodox theoretical approaches such as the post-Keynesian one. Open discussion of these issues is now imperative to avoid the risk of recurrence of the grim drama – not as farce, but as overwhelming tragedy.

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