NEOLIBERALISM AND ECONOMIC CRISIS

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The interwar Great Depression contradicted the tenets of classical liberal philosophy, according to which deregulated economic activity and selfish economic conduct supported the general interest of society. After both practical economy and Keynesian economic theory showed that the environment in which Adam Smith's theories could be verified was rather an ideal typical one, in the late '70s Milton Friedman revitalized the invisible hand perspective in a context in which Western economies were faced with the phenomenon of stagflation. The deregulation of economic life preached by the neoliberal philosophy has engendered, among others, the unprecedented spread of investment funds, that we consider the main cause of the global financial crisis. This article emphasizes the underlying principles of the neoliberal thought.

Keywords: John Maynard Keynes, Milton Friedman, neoliberalism, investement funds, rational market

THE CONSEQUENCES OF FRIEDMAN'S ECONOMIC POSTULATE: STATE WITHDRAWS FROM THE ECONOMY AND INVESTMENT FUNDS PROLIFERATE

The investment funds[1] were the main cause of the international financial crisis, explains Paul Krugman, the 2008 winner of Nobel Prize in Economic Sciences. The uncommon mushrooming of investment funds during George W. Bush administration was thought to have been due to Friedman's principles, which were extensively incorporated in the economic policy of the White House. Only a few decades after the economic recession of 1929–1933 had crumbled the myth of rational market, Milton Friedman, the founder of Chicago School of Economics, argued that the market was a perfect and predictable system, whose dynamics was easy to forecast. Market deviations were not, according to Friedman, the expression of structural weaknesses and thus not related to its essence, but were rather the

[1]"According to Webster Dictionary, hedging means trying to avoid or reduce a loss, by setting up a business, investments, etc. whose gain is meant to offset the loss. In other words, by means of hedging, a person makes investments in order to protect his/her business against the loss arsing from market fluctuations" (Krugman, 2009, p. 137).

result of state's unsuccessful interfering in the economic life[2]. One of the consequences of the Great Depression of the interwar period, which revealed the market incapacity to self-regulate, was the birth of macroeconomics, the economic science according to which the state is the sole institution capable to recalibrate the market. The image of the state, seen as the sole institution that may harmonise the market, aroused idiosyncratic reactions to Milton Friedman, who considered the state to be a coarse institution that lacked the finesse, the perfect interconnection and also the fragility of mechanisms that formed the market gear. According the Friedman's economic postulate, there is a direct connection between the society's freedom and prosperity and state's desire to intervene in the economy. More precisely, the society will be more prosperous and freer if the state's intent to intervene in economic life is more efficiently curtailed. "This attitude was symbolised by the shooting session within a press conference held in 2003, when the representatives of various agencies in charge with supervising banking institutions grabbed pruning shears and power saws in order to cut into pieces piles of regulations. *In more concrete terms, Bush administration resorted to its federal powers, including the obscure powers of the Office of Comptroller of the Currency, for the purpose of blocking the efforts of government authorities to impose a certain degree of supervision of substandard crediting* (s.n.)" (Krugman, 2009, p. 188).

As we are no specialists in economic science, and therefore, we are unable to give a full picture of the strings of recent economic crisis, we shall only try to portray for the reader the economic thinking that generated it. However, we shall also try to provide a technical description of the crisis levers. Recent, and still unsolved in certain parts of the world, the economic crisis arose as a result of the extraordinary spreading of hedging funds, whose benefits are gained by the investors who speculate the fluctuations of the financial market. Hedge fund investments may be *long-term* and *short-term* speculations. Long-term gains are obtained when the value of purchased good (shares, properties) increases on a long-term basis. *Short-term* speculations refer to assets – shares – that the hedging fund borrows from an owner and will return them at a specific moment and at a specific value. Throughout the period over which the fund holds the assets in custody, the financial institution may use them *ad libitum*, i.e. it trades them as it

[2] Friedman's perspective also gains ground within the context of oil crisis, as the barrel price increased from $ 2.70 in 1973, up to $ 9.76 in 1974, and in 1980, following Iranian Revolution, it increased approximately ten times. All of a sudden, the Keynesian model was turned upside down and instead of generating economic growth, its implementation brought about recession. "From that time, nothing worked as usual. Economic growth stopped, prices and unemployment sharply increased, and Keynesian demand-side economics – according to which additional demand, and strengthening the purchasing power of the population through job creation and state investments, could enable governments to cope with economic crisis – became unable to cure the stagnation and decline any longer. In fact, it generated even higher inflation" (Berend, 2009, p. 7).

deems expedient. As a rule, the assets are disposed of or placed in various financial instruments. The short-term speculation may bring profit when assets that are sold at high prices are purchased at low prices before being returned to their owner. This proves the capacity of said financial institution to forecast the market dynamics, and the obtained gain will be most frequently used for long-term investments. Yet, market movements are sometimes misleading, so that the risk that the investor undertakes increases to such an extent that it may no longer be calculated by any mathematic formula, no matter how complex it may be. It is the case of hedging funds that invested in risky financial instruments, such as derivatives (bond issuing) coming from non-performing loans. Thus were being created genuine pyramidal games, within which the risks undertaken by the banks that granted loans to customers of doubtful financial standing, were transferred to investors. As means of absorbing the population cash, the pyramidal games are primitive ways of gathering capital and are usually efficient in the scarce institutional environment of weak states, which can never be in the epicentre of an international financial earthquake. Since investment funds are the main cause of the current international financial crisis, who is then guilty for their spreading? Some people pointed at Alan Greenspan, the leading USA banker over the last twenty years. Other are of the opinion that Greenspan is only the peak of the ice-berg, that is the offspring of a thinking trend, which has claimed back since the ‘60s that the markets have their own intelligence, which surpasses that of the individuals, companies and governments.

Short after the roaring bankruptcy of Lehman Brothers investment fund, the true epicentre of financial earthquake of 2008, the former manager of the American Federal Reserve came before a commission of the American Congress. Following a short discussion with the democrat Henry Waxman, the chairman of the House Oversight and Government Reform Committee, the former guru of finance, confirmed by a slight nod the sudden wonder of the congressman. Waxman had just learnt from the person who was for about two decades the head of the most important financial institution of the United States that recent events confirmed the groundlessness of the economic philosophy whose fun Greenspan had become about half a century ago. Probably Waxman’s surprise had only been surpassed by that felt by the former manager of the American Federal Reserve when, despite the evidences he had gathered for forty years, the market proved not to be a smart and submissive old lady, but was acting rather as an overexcited teenager, who was endowed with some cheap good manners. Several years before the financial cataclysm that occurred further to the breaking of speculative balloons that had been inflated by the investment funds, Alan Greenspan solemnly declared: “Financial markets knew best. They moved capital from those who had it to those who needed it. They spread risk. They gathered and spread information. They regulated global economic affairs with swiftness and decisiveness that governments couldn’t match” (Fox, 2009, p. XII). Greenspan’s economic vision, without fissures before October 2008, started all of a sudden to have deep crevices. As the financial whirlpool that started to swallow flowingly capital markets, homes, dreams and destinies was completely different from the image of peaceful sea that the former head of EDF had created in his mind. As the financial instruments were increasing and growing more and more various, market rationality, transparency and safety did not prove to increase as Greenspan thought[3] for several decades. On the contrary, they encourage the market primary instincts to materialise.

Before the Great Depression of 1929-1930, the economic life was likened to a river, whose navigable channel could be precisely spotted by captains, businessmen, who used as benchmarks Adam Smith's ideas: the market driven by consumers' requirements, the state's non-involvement in economy, and the belief in its natural course as burgeon sprang from individual's innately propensity towards profit gaining, etc. But the ideas that had become axioms under *pax Britannica* aegis proved to be mere theoretical gabbles in between the two World Wars, as the pursuit of individual interest[4] by each social actor could no longer organise the social life and market's self-regulating enzyme was blocked.

JOHN MAYNARD KEYNES AND MILTON FRIEDMAN ON THE ROLE THE STATE PLAYS IN THE ECONOMY

At a moment when the fervent supporters of free market were still optimistic and assured that, once the momentary whims satisfied, the market shall resume its role of social regulatory, John Maynard Keynes gives a distinct picture of economic market in general terms. The central idea exposed in the *General Theory of Employment, Interest and Money* does not depict the marks as a single body holding a superior social intelligence, but as a lifter capable of ascending and descending movements. But this lifter may also block and its stillness causes major social syncope. Market unblocking, which also triggers the revival of economic life, does not take place, as Keynes argues, as a result of exploiting certain concealed features of the market, but following the intervention of a technician,

[3] Greenspan had understood however, in the mid-90s already, that the risks the investors were undertaking were growing bigger and bigger, but considered that the abnormal increase of shares prices was due to the "irrational exuberance" of the market. That is, the market that he had once thought to be cleverer than the governments could also display an irrational exuberance. Reference interest increase from 5.25 to 5.50 is the sole measure that EDF has taken. "If we had increased the interests and invoked the fact that we intended to control the share market, we would have caused a storm full of lightning and thunder. We would have been accused that we intended to prejudice the small investors. That we sabotaged people's pension money" (Greenspan, 2008, p. 187).

[4] "It is not fair at all – argues Keynes – to infer that the principles of economic policy state that the personal interest is always serving the general interest" (Beaud, Dostaler, 2000, p. 42).

and this technician can only be the state. This marked the birth of macroeconomics, a discipline that was sceptical about the intellectual picture that glorified the self-regulatory function of the market.

A few decades after the Great Depression, a period over which the state sought to socially reintegrate a market with vague transcendental impulses, Milton Friedman dusts off the *laissez-faire* principle. The crusade that Friedman initiated in order to reinstate the repute of the market and its hegemonic ambitions towards the society was based upon the argument that market's swanks, which are responsible for social crises, are not imprinted in its DNA, but are caused by state's interfering in the economy. "The basic assumption is that *free market is a perfect scientific system* (s.n.), within which the individuals, driven by their own egoist desires, trigger a maximum benefit for each and all. This inevitably implies that when something goes wrong on the market – high inflation or high unemployment rate – this happens because the market is not really free. Some interference, a certain distortion of the system should exist" (Klein, 2008, p. 57). A certain shock therapy, aimed at removing the obstacles (rules and regulations) that impede profit gaining, full privatisation of state assets and reduction of social programme subsidising, would have brought about a reduction of negative social effects triggered by state's interfering in the economy. The vitality deficit of the market, caused by state's policies, was to be restored by the privatisation of public health, pension, education system, post, as well as of national oil, water, telecommunication, railway and airline companies, etc. "Privatise, privatise, and privatise!" seemed to be the message conveyed by Milton Friedman, who was convinced of the natural discipline of a good and rational market, and not of the truthfulness of implacable time flow laws.

The individual who had the ability to foresee the future becomes the cornerstone of the economic system built by Milton Friedman, the statistician who was drawing up, during the Second World War, forecasts related to the number of pieces into which the missiles that were blown up within a controlled framework should break. An excelent mathematician and statistician, Friedman considers that there is only one way to conduct the economy: by means of mathematic models that are based on the assumption that the economic actor is endowed with a perfect ability to forecast. From here and up to concluding that markets are in their turn rational was only one step. Thus appeared the belief that animated Greenspan for about forty years and whose invalidation required a financial cataclysm. "Friedman believed markets worked better than government. Some of Chicago's finance professors and their students came to believe that markets were *perfect*" (Fox, 2009, p. 94).

ECONOMETRICS IGNORES THE SOCIAL CONDITIONINGS OF ECONOMIC ACTION

Over the first half of the last century, the professor of statistics and economics Holbrook Working noticed that the predictability patterns the financial speculators used in order to approximate the investment risks were not the result of irregularities found in market behaviour, but rather the result of systematic errors that had capped their comprehensive effort. An accurate forecast of price evolution would not mean, as Working argued, that the algorithm used within market dynamics analyses was exact. It would rather imply that the expectancies that the speculator had from the market were incorrect and the erroneous assumption on which the calculation was based lead to a true conclusion. Eugen Slutsky, the assistant of the great Russian economist Kondratieff, resembled most phenomena specific to the economic life to an ocean, whose waves were completely different one from another. Should the observer of economic life have wanted to find out uniformities within a phenomenon that lacked by definition any regularity, he could have done it. Except that the predictability patterns, no matter how sophisticated they were, continues Slutsky, would never exhaust the essence of a phenomenon that is as complex and dynamic as the financial market. It is therefore impossible to predict if the choice that an entrepreneur is to make on the financial markets would prove to be successful or unsuccessful, by means of a calculation formula, which assumes itself the merit of encompassing the infinite behavioural variations of the market.

Alan Greenspan was convinced that this mystery could be solved with the aid of econometrics, "(…) a technical discipline whose basic idea was that the internal phenomena and correlations of a comprehensive and important economic system could be investigated, modelled and analysed from a mathematical perspective" (Greenspan, 2008, p. 43). In 1951, when the young Greenspan started to attend the lectures of econometrics, the ability of economic foresights to show the reality in the most accurate way possible was deemed insufficiently developed, given the experimental stage in which economic mathematics was. Moreover, in a climate dominated by Keynesean ideas, emphasising that the mathematicalisation of economics would loose sight of the social interferences of economic actions which would render economic science more abstract, those that contested the reduction of economics to simple mathematical models surpassed the advocates of this vision. It was a time where the competence of economist did not consist in mathematical and statistical knowledge, but rather in his ability to consider the particular from the perspective of the general; this skill was obtained among others thanks to a comprehensive historical, political and philosophical culture. Since economics is a moral and not a natural science, it uses introspection and value judgements, which explains also Keynes' reluctance with respect to the ability of statistics to show the dynamic of economic cycles, for which time and uncertainty plays a major part. Moreover, there are many other factors – political, social, psychological – that may influence the course of economic life. This explains also Keynes' increasing doubt regarding mathematics' capacity to enclose such a complex world. "For Keynes, economics is not thus a mathematical science closed in itself. It should be opened towards other discipline" (Beaud, Dostaler, 2000, p. 50).

The *Methodenstreit* that occurred in economics at the beginning of 20th century and separated economical history from economical theory was said to have troubled Max Weber to a great extent. The German sociologist considered that economics as a science was comprehensive enough so as to encompass, apart from economic theory and history, the economic sociology. Yet, Weberean perspective did not gain many supporters. On the contrary, theoretic economics clearly won in front of economic history and the economic sociology was disregarded. Joseph Schumpeter, an Austrian economist of worldwide repute and a close friend of Max Weber, finds that several social institutions, such as ownership, family, inheritance, etc. may not be analysed resorting solely to pure economics, which may apply to topics such as value, money and price. Schumpeter argued that the economic institutions should be included in the scope of theoretical economics. That is, they needed an economic sociology (Schumpeter, 1991). In Schumpeter's opinion, the economic theory, which portrays the way people interact, along with the economic consequences of such behaviour, provides the answer to the "*how"* question. Focusing on the evolution of institutions such as the agreement, the private property and the inheritance, the social economics reveals the social drivers that trigger a certain economic behaviour of the people and answers thus to the "*why*" question. In fact, the economic action is a social action that is carried out within a particular institutional framework.

In the mid-'60s, the type of ideal economist changes substantially. This time, the economist's value was appreciated based on his mathematical and statistical knowledge. Back then, the mathematical models were not able yet to remove the degree of risk associated with the choices made by an investor on the market, an aspect that was purely and simply disregarded. But it was incorrectly disregarded, meaning that the assumptions serving as basis for the assessment of speculative behaviours were adjusted. The economic actor was all of a sudden endowed with magical abilities. The individual is neither more nor less assumed to have a perfect forecasting ability. "This was a problem, given that perfect foresight is not just unrealistic but logically impossible" (Fox, 2009, p. 49). We shall not analyse at this point the rational capacity of *homo oeconomicus*. We shall only take over some ideas developed by Vilfredo Pareto, the great Italian sociologist and economist, who considers that although the human behaviour is deemed to be logical, being described with the aid of different intellectual structures (derivations), in most cases the drivers of the social actions are non-logical. In other words, it is not the ration, but a complex of feelings, propensities, instincts, tendencies, tastes, etc. – which Pareto gathers under the concept of residues – that really drive the social actions. Only the derivations – i.e. the numerous verbal manifestations that drape the irrational residue, as constant psychical and affective root of the individual action – are rational.

Greenspan was seduced by Friedman's vision, which simplifies to a great extent the theoretical profile of the genuine economist that was imposed by Keynes. The mathematical equations freed Friedman's economist from the "tyranny" of *quasi-scientific* institution, i.e. from the need to contextualise, to understand or otherwise put, the belief that without investigating the cultural, political, historical and psychological circumstances of the economic phenomena, they will never be completely deciphered. Thus the meanings given to the economic life by the ordinary consumer were renounced and only those defined by the savant were maintained. In our opinion, the economist who deciphers the social order having the feeling of being placed outside it will end by working with utopian models, which considers that "the logic of thought facts and the order of the felt facts" are one and the same thing. In brief, the social circumstances of the economic action were removed and the economic action became abstract and easy to comprise in mathematical formula. Apparently, Greenspan understood the danger posed by purely theoretical perspectives, which were not anchored in the reality. Despite this, he could not defeat the attraction force exercised by the Friedmanean model. He is given away, although he claimed to have permanently sounded out the reality of his time, by the deductive approach[5] that he used when building the mathematical models that forecasted market evolution. It is a known fact that the scientific approach is of inductive type, going from particular to general, from outside to the essence, empirically, with great care and by building patterns based on regularities noticed. The research is deductive only when the assumed premises are absolute, axiomatic truths. I.e. just like Friedman's belief in the rational nature of free market, as well as in the capacity of the social actor to accurately forecast the outcome of his actions in a dynamic and complex environment such as the market. For this reason, the analysis pattern built by Alan Greenspan failed at the contact with the reality.

The danger posed by the excessive mathematicalisation of the economic science had been noticed by Steve Ross back in the '70s. Revealing the hazard related to the hedging funds, the professor of economics considered that unlike the limited volume of the assets that existed on the market – shares, bonds, capital stocks, etc. – that Ross names *primitives*, the number of financial contributions, or *derivatives* resulting from the first category is unlimited. The derivatives were nothing else but the bet that the speculator took, with his ability to rename and place in the best way possible the assets he possessed, but which, in most cases, did

[5] "Initially, my training method consisted in conducting a full analysis of the details of a small part of the world and *inferring* (s.n.) then, based on such details, the way in which the said segment of the world behaves. This is the process that I applied throughout my entire career" (Greenspan, 2008, p. 45). But Greenspan remained blocked on the particular and could not understand the general. In other words, he could not see the wood from the trees.

not belong to it. The shock wave produced by the breakage of a speculative balloon had already been felt by interwar companies. Except that the terrible offensive of Friedman's theories on the market as unique system masks these older events. The result was the mushrooming of investment funds and their natural corollary: the financial crisis. "Ever since the Great Depression, the dominant regulatory approach to taming financial risk had been to restrict what financial institutions and investors were allowed to do, to reduce the number of financial bets that could be made. The regime was already under sustained assault by the 1970's from both the political right and economic reality" (Fox, 2009, p. 150).

NEOLIBERALISM. TWO WAYS OF SEEING IT

According to David Harvey, neoliberalism can get two interpretations. On the one hand, it can be read as a utopian project to revitalize the capitalist system, whose economic and social efficiency has been questioned by the oil crisis started in the '70s. And on the other hand, neoliberalism can be expounded as a policy strategy to recover legal and institutional framework favorable to the primitive accumulation of capital either to reinforce the position of power of a political and economic elites threatened by the growing strength of trade unions and socialist parties, or to forge a new economic elite as it has happened in Boris Yeltsin's Russia, Deng Xiapoing's China or Margaret Thatcher's England. Also, the application of neoliberal program in the United States of America since the end of the seventies emphasized social imbalances. For example, the share of the national income of 1% of individuals with the highest earnings climb, almost to the end of the twentieth century, up almost 15%, recalling the previous polarization of the Second World War. It is noteworthy that 0.1% of individuals with the largest increase their earnings from 1976 to 1996, the share of the national income from 2% to 6%. The ratio between the salaries of managers of transnational corporations and those of lower staff increase from 30 to 1 in 1970 to 500-1 in 2000 (Harvey, 2005). 'Almost certainly, the reforms of the system of taxes and duties undertaken by the Bush administration, which now produces effects, the concentration of income and wealth in the upper echelons of society continues quickly, because the wealth tax (estate tax) is eliminated, and income taxation investment and capital gains is reduced gradually, while taxation on income and wages is retained'' (Harvey, 2005, p. 16–17). Without going into too much detail, we demonstrate the junction of U.S. neoconservative philosophy and the current neoliberal. The architects of the American neoconservatism were the Hebrew intellectuals at City College of New York. Disappointed with the utopian character of communism, specifically said the existing cleavage between the social doctrine and its purpose, the philosophers and sociologists at CCNY have understood the limits of social engineering. A vision that tracked adverse effects of too frequent incursions of the state in society obviously agreed with the perspective that condemns the intrusion of state in the economy. But the perverse effect of eliminating the state from the social welfare sector which was manifested by increased state involvement in specific activities of national security. Welfare state becomes the state of monitoring.

IN LIEU OF CONCLUSION

If internally it secured a political and economic hegemony of the elite, by the way in which it has regulated international lending, the neoliberal vision preserved the preeminence of the metropolis. And we offer an example in this respect. If entrepreneurs in developing countries want to attract money from international financial markets, it is necessary that their home state to have significant reserves. Moreover, it is obliged to invest some of those reserves in bonds issued by the metropolis. Therefore, if the banks from the central modern world system lend entrepreneurs from a state located in the periphery, then the state in question is obliged to finance the budget deficits of the metropolitan states. But there is a consistent difference between the interest charged for loans to private sector in a developing country which is approximately 12%, and the interest offered, for example, the U.S. state of his investing in bonds, about 4% (Harvey, 2005). The result is natural. Draining capital gains from suburbs members the gap between the metropolis and suburbs modern world system continues to widen. Thus neoliberalism contributes to the hightening of national and heighteinng global disparities.

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