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The global context of economic crises and cohesion funds in the EU

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Abstract. *The currently finalized financial crisis, which began in the US then spread to Europe, has become global at some point. Even the emerging markets and the less developed countries that have managed their economy well, have resisted unfavorable lending practices, kept high levels of foreign exchange reserves, bought no toxic mortgages, and did not allow banks to engage in excessive risk through financial derivatives so they get involved and suffer as a consequence. Any global solution – short-term measures to stabilize the current situation and long-term measures to make another less likely reappearance – must pay due attention to the effects on these countries. Without doing so, global economic stability cannot be restored, and economic growth as well as global poverty reduction will be threatened.*

Keywords: global context, economic crisis, Gresham's law, deviation, recession.

JEL Classification: G01, H11.

Introduction

East Asian countries came out of their crisis more than a decade ago, relatively quickly, because they could head to export markets, so their outbreak was the export itself. Last year, the only source of economic power in the US was exports. A global crisis requires a global response, but so far our responses are national and unional (EU case). Each country has focused on its own compromises, the incentive it derives from spending on costs in increasing national indebtedness, for example. The benefits of other countries from rising costs are externalities, which they will not take into account, unless there is coordinated action. Worse, each country will be tempted to maximize its multiplier demanding that its neighbor policies endorse or empower its internal stimulus package. Although there has been a relief when additional language has been introduced with regard to the suspension of this provision, to the extent that it has violated international agreements, this has been strangely made by providing to a certain extent, plurilateral agreements public procurement with other advanced industrial countries but not with most developing countries. In short, there will be discrimination against poor developing countries that need the help of developed countries and more.

If each country focuses solely on its own interests, some countries will be tempted to be free pilots. The size of the global stimulus will be lower than necessary and the overall impact will be lower, each trying to find those expenditures that have the most internal multipliers, regardless of global multipliers. There is an enormous difference between domestic and global multipliers and an effective global response must focus on global multipliers.

Global context

America has a special obligation to behave responsibly. This crisis has a clear “Made in the USA” label. Toxic mortgages were created and then exported – about half of them to countries like Iceland. Once again, we have benefited from globalization: if it were not exported so much, the US would have had a deeper crisis. Banks would have had even more serious problems. The deregulation philosophy was exported, which meant that many elsewhere did not implement guarantees that would have prevented them from buying these toxic products.

Governments have intervened in the markets in an almost unprecedented way – and even if some governments are calling for greater transparency, we have to recognize that much of what has been done has been extremely unobtrusive. With the expense of this scale and the lack of transparency of this scope, enormous possibilities of corruption and inappropriate redistribution are opening up. I was moving on an endless territory.

The distortions created in the market economy will have a long duration. There can be no level playing field, with governments in some developed countries offering their businesses billions of dollars worth of subsidies that poor countries cannot offer. Even symmetrical policies can have asymmetric effects: a government guarantee for a US bank deposit has more credibility than one in a poor developing country.

Problems are even worse in financial markets, as firms in some developed countries receive hundreds of billions of dollars of assistance, well above the GDP of poorer countries. Even knowing that failure can be met with a rescue plan changes availability and the ability to take risks.

The global economic landscape has undoubtedly changed. We cannot return to the world before September 15, 2008. The question is: what kind of world will be over years and years? In the past, the global financial system has often been at the disadvantage of developing countries. Banks in developed countries, for example, have been encouraged to lend short-term loans to developing countries; while it provided greater liquidity to the premium, led to greater instability in the latter case. For years, the liberalization of the financial market and the capital market could have given additional funds to developing countries. Procyclical monetary and fiscal policies have often been adopted in developing countries, while developed countries have followed counter-cyclical policies.

These asymmetries mean that there is a higher risk in developing countries, forcing them to pay a higher cost of capital. In combination with last resort guarantees and rescues, these asymmetries are also partly the abnormal situation in which money flows from developing countries back to the US, where global problems arose.

It is understandable that each country focuses primarily on its own citizens and on its own economy, but it would be a mistake not to recognize the consequences of the actions of developed countries. At the very least, we may need compensation payments to compensate for the damages that we have countries like the US have done it to others. It is not the time to reduce foreign assistance; this is the time to grow it.

The rest of the world will watch closely what the US is doing during Donald Trump 's first term. The way the US responds will have much to do not only as fast and robust as the world gets out of this crisis but also on the nature of the global economy in the post-crisis world. Will there be closer economic integration? Or will it be a retreat from globalization?

A diagnostic approach to recession causes

The neoclassical business cycle model suggests diagnostic procedures to assess the role of productivity and other possible sources and mechanisms that drive the current recession. These procedures diagnose potential sources of economic fluctuations by building a neoclassical business cycle model, feeding data from cyclical episodes, and then measuring deviations in equations that characterize model balance in the absence of shocks. In this section, I describe how this procedure works and summarize the results.

I start with a neoclassical business cycle model using model parameters that are standard for this approach. The production function is the Cobb-Douglas production, with one-third of capital factor income and two thirds of labor for income. Family preferences for consumption and recreation are logarithmic. A leisure time parameter generates the feature that steady-state hours are equal to about one-third of the time spent in the household.

Reducing domestic work in the future generates a real interest rate of 4%. Capital is depreciated at an annual rate of 7% and exogenous technological growth generates a steady growth rate of production, consumption and investment of 2%. These parameters are selected or calibrated so that the model matches the long-term path of the US economy.

A combination of maximization means that the model of the neoclassical business cycle requires four theoretical standard relationships between production, labor, consumption and investment: first, the production function, which requires a relationship between inputs and outputs; secondly, a decision to allocate the household time between time spent on the market and leisure time, which is equivalent to the marginal rate of substitution between consumption and recreation with the salary received by the household, which in the basic version of this model is equal to the marginal product of labor; third, a consumption/investment allocation decision between consumption and investment, where the current consumer price in terms of consumer consumption tomorrow is the real saving rate or the real interest rate. Therefore, this decision equates to the marginal intertemporal rate of substitution between current consumption and consumption in the future for returning to the investment in physical capital, which in the basic version of the model is equal to the marginal product of the net depreciation capital. Fourthly, a resource constraint shows the allocation of expenditure between the final requirements of consumers, firms and government and net exports.

The analysis of this component is based on quarterly data after the Second World War for the United States and six other high-income countries. For each quarter, we analyze actual production, consumption, labor and investment data in these four theoretical model relationships described above. With some algebraic manipulations, these data provide measurements of all the terms in these four theoretical relationships. For example, capital, labor and production data are linked to the production function so that production is equal to its production function value. In the household allocation decision, a numerical value for the marginal rate of substitution between consumption and rest can be derived from the household utility function, while the marginal product of labor can be derived from the production function so that the marginal rate substitution between consumption and leisure are equal to the marginal product of labor. Similarly, in the consumption/investment allocation decision, a numerical value for the marginal intertemporal substitution rate between today's and future consumption derives from the utility function and the marginal product of the capital can be derived from the production function so that the rate marginal intertemporal substitution is equal to return on investment in physical capital.

However, when the numerical values in the quarterly economic data are introduced into the model in this way, the four theoretical relationships will not be met. Instead, there will be errors or deviations between the components of these equality. When looking at the relationship of the production function, for example, there will be a deviation between the output generated by the production function and the actual production of the economy. This deviation, which measures the difference between real output and output component that can be calculated by measuring labor and capital inflows, forms the basis of the Solow production function (1957).

When analyzing the decision to allocate household time between work and leisure, there will be a deviation between the numerical value derived for the marginal substitution rate and the derived value for the marginal product of labor. Note that this deviation in the household time allocation equation is equivalent to a labor income tax, since this labor deviation is a slope between the marginal household substitution rate and the marginal labor product, just as a labor income tax determines a slope between the marginal substitution rate and the marginal product.

In addition, when considering the consumption/investment allocation decision between consumption and economy, there will be a deviation between the numerical value derived for the marginal intertemporal substitution rate and the derived value for the marginal product of the capital. We note that this deviation in the household consumption/investment equation is equivalent to a capital income tax, as this deviation generates a slope between the marginal intertemporal substitution rate for households and the marginal product of capital, just like a capital income the tax drives a slope between these two measures.

Deviations that appear in the first three theoretical relationships provide a diagnostic tool to look at the underlying causes of the recession. We refer to these as the productivity deviation (the deviation that occurs in the numerical estimates of each part of the production function), the deviation of the labor force (the deviation that occurs in the numerical estimates of each part of the household allocation decision), and the deviation of capital (the deviation that occurs in the numerical estimates of each part of the consumption/investment allocation decision between consumption and investment).

The tax interpretations of labor and capital deviations are useful in identifying sources of recession. More specifically, it can be shown that hours worked during the 2007-2009 recession are far too low compared to the marginal product of labor. Thus, the key to understanding this recession is to find a factor that works as a high increase in labor income tax, which reduces labor depreciation relative to the observed marginal product of labor.

Table 1 provides information on these three deviations, which can be used to compare the US experience during the 2007-2009 recession with the average of other post-World recession recessions, and to compare the US experience in the recession 2007-2009 to parallel recessions in other High Income Countries: Canada, France, Germany, Italy, Japan and the United Kingdom. Each deviation is built by first linking the production function, the work decision and the consumption/investment allocation decision to the actual data, then taking the ratio of the left-right sides of each of these three conditions and then subtracting one of each of these reports. We will look for negative deviations in these three conditions to shed some light on the recession 2007-2009. In particular, a negative productivity deviation means that output is below the level generated by labor capital and input and production function; a negative deviation of the workforce means that employment is below the level compatible with the marginal product of work; and a negative capital deviation means that consumption growth is below the level that is in line with the marginal product of capital.

Table 1. *Deviation from recession, 2007-2009*

	Deviation of work	Deviation of capital	Productivity Deviation
A: USA			
Post World War II Recession	-2.4	1.8	-2.2
Dates 2007-2009	-12.9	0.3	-0.1
B: USA vs. other high income countries, 2007-2009			
US	-12.9	0.3	-0.1
Canada	-0.9	0.7	-7.0
France	1.7	1.3	-6.1
Germany	4.8	-1.1	-7.0
Italy	-0.8	0.3	-7.2
Japan	2.9	-0.4	-7.1
UK	-2.3	0.0	-8.2
Average high income countries	0.9	0.1	-7.1

Source: author interpretation according to OECD and World Bank databases, 2018.

The first column in Table 1 refers to "deviation of work". Again, the theoretical relationship in the household allocation decision tells us that the marginal rate of substitution between consumption and leisure will be equal to the marginal product of labor. However, the first row of the table shows that during the recession after World War II the deviation is -2.4%, which means that the marginal product exceeds the marginal substitution rate by an average of 2.4%. This typical US model of marginal product growth relative to the marginal rate of substitution is equivalent to an increase in the income tax rate of the same proportion as the theory otherwise states that the occupation should have been higher.

Labor productivity gaps in the 2007-2009 recession in the United States also stand out against the other six high-income countries. Panel B shows that all of these countries have made much smaller changes in labor deviation, with an average change of only 0.9%. In fact, there are considerable positive deviations in France, Germany and Japan, which means that employment in these countries is actually higher than the level consistent with the marginal product of labor. Until mid-2008, the labor market deviation for the United States was very different from the one in the other six countries, and this gap between the US and foreign labor deviation continued to increase.

The second column in Table 1 is the capital deviation. It results from bringing the quarterly economic data to the consumption/investment allocation decision, the theoretical condition that equates to the marginal intertemporal substitution rate in consumption and the net return on investment. When the actual data is applied to relationships in the base model, a deviation occurs between these values.

The capital deviation shows that the net return on investment was about 1.8% higher in the recession after the Second World War compared to the expansion. This is not just a small deviation, but when it is discussed as a tax on capital income as described above, it is equivalent to a small tax cut rather than an increase in taxes that would affect economic activity. Note that there was almost a capital deviation in the US recession in 2007-2009.

Indeed, a more detailed analysis shows that each recession analyzed here – that is, all post-war recessions during the Second World War and the recession 2007-2009 in all seven economies – has either a large deviation from the labor force, or a high productivity

deviation. But there are no large and negative capital distortions during these recessions, including the 2007-2009 recession in any of these countries.

The third column in Table 1 shows the "productivity deviation", which is based on the production function. In a standard business cycle analysis such as Kydland and Prescott (1982), the deviation between output and inputs from the production function is just the famous Solow residue, which can be seen as a measure of productivity change. However, the Solow residue takes over all the output changes that cannot be accounted for by the measured inputs, and not just the modification of the technology. Thus, productivity deviation will raise all the factors that change the relationship between measured labor and capital and measured output.

All recessions in non-US economies show substantial productivity reductions of 6% and more. In US experience, some post-World War II recessions show a substantial productivity gap, including the large recessions of 1973-1974 and 1981-1982. Total factor productivity declined by more than 2 percent during the recession after World War II, but there is almost no overall factor productivity deviation in the US recession from 2007-2009. Other productivity measures show little change, including real hourly production and real hourly production. As in the case of labor deviation, the productivity deviation in the US is considerably lower than in the other six countries since mid-2008 and continues to remain lower afterwards.

The fact that there is essentially a decline in productivity suggests that the sources and mechanisms of the US recession in 2007-2009 differed substantially from the post-war recessions in the United States and the parallel recessions in 2007-2009 in other high-income economies. In contrast, the US recession in 2007-2009 seems to be almost exclusively linked to a factor that significantly affects the labor market by changing the relationship between the marginal substitution rate and the marginal labor product.

In order to further understand the relative importance of labor deviation for the 2007-2009 recession, we are simulating what would happen in the US economy if this deviation was the only one that took place, as in Mulligan (2010b). We have found that labor deviation can practically represent the entire US recession in 2007-2009, with simulated output, employment and investment shifts, which roughly fit with what has happened. Otherwise, in the absence of this labor force gap, the labor force contribution during this recession was about 10% below the level that should have prevailed, given the marginal product of labor. However, in all other post-war recessions, labor deviations are large enough to account for one-fifth of the full decline in real output and about half of the drop in workforce.

These findings suggest that understanding the US recession in 2007-2009 requires a labor market theory where employment is well below its normal level. While the US recession in 2007-2009 is unique compared to all other post-World War II recessions, it is qualitatively very similar to the Great Depression. During the 1930s, the number of hours worked per capita and production remained well below the normal levels, indicating a very high labor force deviation. Like the recession from 2007-2009, the 1930s deviation

reflected a marginal labor product that substantially exceeded the marginal rate of substitution between consumption and leisure. Specifically, the average labor force gap between 1930-1939, calculated in the same way as in the post-war recession, is about -26%, about twice as high as the 12-year labor force, 9% in the third quarter of 2009.

Lessons of economics

We continue to discuss a part of the lessons from the economic crisis of 2007. Great Depression has transformed the current economy. Even when the economy plunged into depression, most of the economic profession argued that nothing should be done, because government intervention would only make things worse. As the depression disappeared in distant memory, the economic profession lost sight of these lessons. The dogmas and doctrines that claimed that the markets were performing well and that they had self-corrected once again became predominant. This time, theories were more sophisticated, but the underlying assumptions were equally irrelevant. These ideas helped shape the intellectual media that gave rise to flawed policies that in turn gave rise to the crisis and, to some extent, they are shaping policies today as we try to respond to the crisis.

Perfect market advocates in all their versions say that syncope or crises are rare events – though they are happening with increasing frequency, changing rules to reflect beliefs in perfect markets. We could argue that economists, like doctors, have much to learn from pathology: we see more clearly in these unusual events how the economy really works.

Following the Great Depression, a special doctrine, called neo-classical synthesis, was accepted. He argued that once the markets were restored to full-time employment, neo-classical principles would apply – the economy would be efficient. It should be clear: it was not a theorem but rather a belief. The idea has always been suspicious – why should market failures only occur in high doses? Rather, the recession can be seen as the tip of the iceberg; below these are many smaller market failures, leading to aggregation to enormous inefficiencies – illustrated by a multitude of tax paradoxes.

We must also remember that, while large failures were rare in the US on a global scale, failures were, in fact, frequent. This is just the biggest and the most recent financial crisis – and rescue. Beyond the 2007 American disaster, there are situations in other countries (Mexico, Brazil, Korea, Indonesia, Argentina, Thailand, Russia, etc.) that were really in need of saving Western creditors and the result of inappropriate credit assessment. The main difference between these crises and the current one is that there were consequences in the "periphery" – and the rescue costs were largely borne out of the periphery.

The irony, of course, was that other components of modern economic theory, including the theory of imperfect information, simultaneously explained why markets often do not work so well. Greenwald and Stiglitz, for example, showed that the invisible reason of Adam Smith's hand was often invisible because it was not really there: market equilibrium was not constrained Pareto efficiently whenever there were imperfections and asymmetries of information and markets imperfect risk. At the same time, the countries of East Asia, which

had the greatest success in terms of economic growth and poverty reduction, pursued policies with the active involvement of the government. It would have been thought that this powerful combination of theory and evidence could have mitigated the enthusiasm for free and sub-regulated markets. But obviously he did not. We understand the unusual enthusiasm of special interests that have found the arguments for increasing deregulation profits.

There were also arguments that risk is the price we have to pay for innovation, and the financial markets of North America have been tremendously innovative. However, financial markets have not created risk products that would have allowed individuals to manage the risks they faced – simple ownership of the dwelling. Rather, innovations consisted mainly of fiscal, regulatory and accounting arbitrage. Their financial alchemy – the conversion of F rated mortgages into financial products that could be held by fiduciaries – had a private (but not necessarily social) remuneration. Such repackaging, which we know from Modigliani Miller's theorem, should have a limited maximum value. Meanwhile, many in the financial sector have in fact withstood the innovations that would have made markets work better – innovations such as GDP and inflation-linked bonds, Danish mortgage bonds and better bids of treasury bonds.

Models that have predominated in macroeconomics, which assume representative agents with rational expectations, are particularly disturbing, as we are now discussing some examples of irrationality in the economy, namely:

1. Markets believed real estate prices could continue to grow – a belief needed for toxic mortgages that should not explode – and yet the real incomes of most of the population in developed countries have fallen.
2. Markets seemed to systematically ignore the possibility of strongly correlated house price movements, even if these prices were affected by national interest rates and the general business cycle, and markets seemed to ignore the possibility of contagion related to the interconnectivity of the economy, and expectations.
3. “Once in a lifetime” are the events that actually took place every 10 years. It would have had to use simple econometric distributions rather than log-normal distributions. There have been several cases of failures in the use of these models – obviously, the financial markets have not learned.
4. Markets have offered 100% or more non-recurring mortgages. He should have acknowledged that (at least with rational buyers) these were an option with positive value: they were giving money. It is not the standard model of banks to give money – at least to those with low incomes. Both investors and regulators should have admitted that something was wrong.
5. Supporters of the new products have argued that they are transforming the economy – only such fundamental transformation could justify the high salaries they have received. However, in modeling, they used the previous data, which implicitly supposed that nothing has changed. However, something has changed – new information asymmetries have been created, which investors have not fully appreciated and did not consider their modeling. Mortgage loans with much higher default rates were granted.

6. The system was full of perverse incentives – from rating agencies, from mortgage-makers, from securitization and from banks. There have been conflicts of interest, incentives to provide distorted information and incentives to engage in short-term and excessively risky behavior. But in a way, investors – the other side of each of these transactions – have irrationally assumed that these perverse incentives have had no adverse effects.
7. Banks were allowed to become too big to fail but did not take into account the effects they would have on their behavior. Derivatives have played an important role in amplifying the crisis. Large banks have failed to withdraw derivative positions. Obviously, they have failed to recognize the importance of counterparty risk, even if they bet on counterparties' failures – another example of intellectual incoherence.

Cohesion policy

Cohesion policy is the EU's main investment policy. This policy is addressed to all regions and cities in the European Union. It complements other EU policies such as education, employment, energy, the environment, the single market, research and innovation. In particular, the Cohesion Policy provides the framework and the investment strategy needed to meet the agreed growth targets.

Cohesion policy is a catalyst for additional funding from public and private funds, as this requires Member States to co-finance from the national budget and also confers investor confidence. Cohesion policy objectives are achieved through three main funds:

1. The European Regional Development Fund (ERDF) aims to strengthen economic and social cohesion at regional level by investing in growth-enhancing sectors in order to generate jobs. At the same time, the ERDF finances cross-border cooperation projects.
2. The European Social Fund (ESF): invests in people, focusing on improving opportunities for employment and education. It also aims to support disadvantaged people who face the risk of poverty or social exclusion.
3. The Cohesion Fund: invests in green growth and sustainable development and improves interconnection in Member States with a GDP below 90% of the EU-27 average.

These consist of the European Agricultural Fund for Rural Development (EAFRD) and the European Fund for Fisheries and Maritime Affairs (EMFF), European Structural Funds and European Investment Funds.

By 2020, the EU is pursuing five concrete objectives – employment, innovation, education, social inclusion and climate/energy. Each Member State has adopted its own national targets in these areas.

In 2014-2020, € 351.8 billion – about one third of the total EU budget – was allocated to cohesion policy to meet these objectives and meet the diverse needs of all EU regions. The most much of the funds available to cohesion policy are geared towards less developed European countries and regions to support them in order to recover and reduce further economic, social and territorial disparities across the EU.

The level of investment reflects the development needs of the Member States. Regions are classified according to their gross domestic product (GDP) in more developed, transition or less developed regions. According to this classification, funds provide between 50% and 85% of the total funding of a project. The remaining funding needs may come from public (national or regional) sources or private sources. The overall policy objective is to boost the competitiveness of Europe's regions and cities by encouraging growth and job creation.

Absorption of European funds on operational programs

Acquiring the European Union (EU) membership has brought Romania a number of benefits and opportunities for development. The most important of these is the structural funds available to the Member States to help create a thriving, stable and homogeneous economic system in the Member States of the European Union and their regions.

Structural Funds are the most important economic policy measure adopted by the European Commission (EC) to influence (positively) the economic development of the states that are part of the large European 'family'. The primary goal pursued by the EU by providing these funds is to harmonize levels of economic development between states in order to stop the economic downturn of Europe and reduce existing gaps between developed and less developed regions.

The way these funds are managed is the responsibility of the Member States, which have the task both of determining where these resources will be allocated (based on identified needs) and of attracting and actually spending that money.

Union-level communities have structural funds covering a wide range of areas where interventions can be made to develop and modernize them. These projects focus on financing infrastructure projects, the professional redeployment of the unemployed, and the technological improvement of agricultural machinery.

The Structural Funds are “financial instruments through which the EU acts to eliminate economic and social disparities between regions in order to achieve economic and social cohesion” (Balogh and Negrea, 2009). For the period 2007-2013, there are three financial instruments, called Structural Funds: the European Regional Development Fund (ERDF or ERDF), the European Social Fund (ESF) and the Cohesion Fund (FC).

For Romania, Structural Funds are a basic tool in terms of economic recovery, continuation of change and acceleration of the reform process, to reach the level of other European economies. With EU accession, national economic activity is steadily moving towards the outside. At present, the economy of a state is of interest to both the state and the other Member States, which chose to join the big European economies. The economic decline of a country also affects other European contributors, and once an economic problem arises in a state, it becomes a common problem for the whole of the Union (for example, Greece's economic problems).

Absorption capacity is “a variable that manifests itself differently in the Member States”, which determines the need to identify individual solutions, tailored to and tailored to the

specific needs of each country in terms of eliminating obstacles and difficulties absorption of European money. The absorption capacity is of two types, namely – absorption capacity on the part of the offer (of funds) – consists in the creation of the institutional system by a state, necessary to manage the European funds; and – absorption capacity on demand (funds) – refers to the ability of beneficiaries to absorb the funds that are addressed to them. Absorption capacity on the supply side is influenced by three factors (Transparency International Romania, 2011): Macroeconomic absorption capacity – presented and explained in line with GDP; in this respect, Council Regulation no. No 1260/1999 shows that the annual amount allocated to a Member State from the Structural and Cohesion Funds should not exceed 4% of GDP; at the same time, the macroeconomic absorption capacity also implies the need to increase budgetary expenditures as a result of accession but also the absorption capacity of the additional expenditures to be made – the financial absorption capacity – lies in the ability of a state to provide co-financing for programs and projects benefit from EU support, the capacity to plan and guarantee these contributions from the national budget and the capacity to collect contributions from partners involved in different actions, projects or programs, and – administrative capacity – consists of the capability and competence of central and local public administration to prepare projects and programs in a timely manner, to finance and monitor them during implementation, to comply with administrative and reporting requirements, to avoid certain irregularities, and to ensure effective coordination with partners involved (Transparency International Romania, 2011).

Conclusion

Even today, irrational and mistaken thinking continues. We are inclined to encourage mergers between large banks that make them even bigger. We are talking about a close regulation of systemically significant institutions, failing to mention that there may be systemic effects of correlated behavior on the part of individual institutions, even if each of them is not systemically significant.

Models of representative agents ignore the rich diversity of the global economy – a diversity that is at the heart of some of the problems they face. A single- person economy does not have creditors and debtors, there are no asymmetric information problems (unless they are subject to schizophrenia), no banks are needed, no creditworthiness – in short, everything is important. Remarkably, much of the economist profession has focused on models that have little to say about the crisis we are facing.

There were other directions of thought. Minsky has returned to fashion at the academic level. Greenwald and Stiglitz (2003) have developed formal deflation models and a monetary policy theory focusing on the role of credit. With Gallegati and other co-authors (2008), we explored the credit interconnections that have played such an important role in this crisis. These models explore the possibility of bankruptcy cascades. This explains how global financial integration can serve not only to share risk but also to facilitate contagion because a failure in a part of the economic system – in this case, the US – is spreading

throughout the world. Neo-classical models have argued that globalization has inevitably led to greater stability. Just before this crisis, there is more and more contradictory evidence.

There are other arguments against inflation targeting – especially in developing countries. Those countries that have tried to mitigate this imported inflation distorted their economy; nothing could affect the prices of oil or food. In some cases, only 25% of prices were directly affected by high interest rates – in order to reduce the average inflation, a huge price was imposed for those sectors at that time. However, high interest rates have led to higher rates of exchange, which have now fallen, subjecting the real sector to huge volatility. An attempt to stabilize inflation has served to destabilize the global economy.

The unfavorable financial markets are not working and current regulations and regulatory institutions have failed – partly because it is unlikely to get effective regulation when regulatory authorities do not believe in regulation. Markets do not self-regulate, at least within the relevant timeframe.

Generally, Darwinian natural selection may not work. Rather, like Gresham's law – claiming bad money is conducting good business-wrong firms forced firms more conservative to follow similar, reckless investment strategies. More prudent businesses could have done better in the long run but could not have survived to take advantage of the long term.

Our financial system has failed in its core missions – capital allocation and risk management – with disastrous economic and social consequences, not only on the mismanaged capital in the past, but also on the enormous disparity between the potential and the current GDP in the years to come, in the amount of trillions of dollars. Unfortunately, the wrong economic theories have helped and urged both the public sector and the private sector to pursue policies that almost inevitably led to the current calamities.

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