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The Need of a New Economic Model

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Abstract. *The current global economic crisis has proven to be unpredictable for most decision-makers worldwide. Moreover, beliefs deeply embedded in the minds of economists about economics, about the virtues of capitalism and free market began to falter. Sooner or later the current crisis will end. The problem that arises and to which the economic science must answer is whether anything should be changed in the current world economic order and especially what exactly. It is quite vital to ask ourselves today in what kind of society we want to live and whether the current economic model, a model mainly based on monetarist ideas, is helping us to achieve those wishes. In addition to analyzing the root causes that led to the current economic crisis, this article aims to analyze whether the current economic model must change and to outline the features of a possible new model.*

Keywords: economic crisis; economic model; globalization; economic theory; economic cycle.

JEL Codes: E02, E44, F02.
REL Codes: 6B, 6E.

Introduction

In the autumn of 2008 the world economy was in deep crisis. Although the crisis started in the US economy it became global very quickly proving once more that we are all in the same boat.

Over the last two decades there have been several successive crises in emerging countries. But their extent was not very high and they finished out relatively quickly the developed countries had the necessary resources to support the ones in trouble. The major difference is that the current crisis has not originated in emerging behavior but appeared right in the center of the global economy (due to the US subprime lending) and contaminated world.

The crisis has brought up some old issues related to global imbalances (in the form that one part of the world produces and consumes more than the other, a thing which threatens the global stability) and to the American model of weak social cohesion and lack of morality of the participants to the stock market.

This article is divided into four parts. The first part presents a comparative analysis of the American model with the two sub-models of the economy proposed by the Bush and Obama administrations, sub-models that have failed to prevent the crisis (Bush sub-model) and to overcome them at a low cost to taxpayers (Obama sub-model) . The current global economic crisis originated in the US and this is why it is important to analyze the real causes which led to the emergence of this crisis and how the authorities reacted. The second part analyses the crisis in which the economy as a science is caught between two visions: the morality of individual interests and the unique interests of the collective. The third part is devoted to the issues of morality and common sense, two important things which seem to be minimized, if not downright ignored, by many key players, both from the political sphere and the economic sphere. The last part tries to answer a question of utmost importance to human society, respectively how a new economic model could look.

1. The American model

When we talk about economic models is important to correctly understand the concepts that we use. Thus the concept of economic systems and models covers a vision, a well-defined structure and purpose, together with methods and procedures to achieve economic performance. A model of economy refers to the vision of the regulators and how to manage economic functions and solve “the equation” of economy as a whole. The link between economic systems and economic models is the following: systems represent the commune sides and models the specific differences. The system is functioning as a hole while the models define the procedures and tools which make the system to function (Dinu, 2011).

In the following part I will present the main measures adopted by the two American administrations which were at the lead during the crisis, respectively the Bush administration and the Obama administration.

Bush administration reaction to the financial crisis has been to help banks through a massive 700 billion dollars suggestively called "Troubled Asset Relief Program or TARP". The US treasury TARP allowed the government to buy assets that were very difficult to evaluate or were very little liquid, belonging to banks and other financial institutions. The assets in questions were the CDOs (Collateralized Debt Obligations), which represented an investment instrument particularly popular until 2007, when they were affected by the growing number of cases of non-payment of mortgage loans on which they were built.

But the problem in the US was not just about banks facing debt default by borrowers. Soon the financial crisis became full scale economic crisis. Two of the three major US auto industry giants found themselves on the verge of bankruptcy. They were General Motors and Chrysler. President Bush has postponed the matter until his successor will be installed in office, helping businesses just to keep afloat. These financiers who had requested the help of government were of the opinion that the auto companies should not receive the same treatment from moral hazard considerations. It has been a battle of opinions between Main Street (represented by the non-financial corporations) and Wall Street (represented by the financial corporations) from which emerged the winner – Wall Street. It is obvious that a double standard was applied, financial companies benefiting from a more gentle treatment from the state.

Another measure taken by the Bush administration was to reduce the taxes imposed in February 2008, a measure that has not produced the desired results because much of it was saved by the beneficiaries and its objective was to encourage spending.

Regarding the financial regulation Bush administration really didn't do anything although it was clear that this area of regulation of financial markets is the main culprit. Nor in terms of social cohesion the Bush administration has not taken action, although the main beneficiaries of tax cuts were on the top. An more intense progressive taxation would have been much more useful because it would have led directly to an increase in consumption not in the savings and we all know that in times of crisis it is important to encourage consumption.

Following the failure of Paulson plan (which failed to revive lending) Obama administration announced a new program in March 2009 – PPIP (Public Private Investment Program). The US Treasury and the Federal Deposit

Guarantee Authority (FDIC) launched a program through which they wanted to solve the problem of toxic assets in the custody banks. PPIP involved the auctioning of these assets and investors who agree to buy some of them would have received collateral which worth about one trillion dollars from the FDIC.

The Obama administration has not really come up with a new approach but with a strategy based on trust and continuity. The stimulation package consisted of 800 billion dollars whitch wore to be spent over a period of approximately two years. This sum of money is not big at all if we take into account the US GDP of about 14 – 15 billion US dollars. Thus, in 2009, the resulting stimulus package was almost zero (Stiglitz, 2010, p. 127).

Congress approved three extensions of the period of unemployment paid from the federal budget to a maximum of 73 weeks. Also the stimulus package proposed by Obama included the covering of 65 percent of the cost of health insurance as part of extended unemployment help (only if the who have lost his/her job after September 2008 and before the end of 2009).

Obama administration may be accused that it did nothing to help out the Americans who have lost their jobs to pay their rates on mortgage loans. So many of those left unemployed have lost their houses shortly after the dismissal although they were not guilty of anything. The Nobel prize winner for economics Joseph Stiglitz propose that the authorities should provide a new type of "insurance risk", which in the present circumstances would take over the mortgage payments – allowing most to be postponed until the owner will find a new job (Stiglitz, 2010, p. 135).

Obama administration stimulus program had many positive effects, but would have been more effective if it was bigger and better designed. Thus, because it was too small, one-third to tax cuts passed on, and some little aid has been allocated to states, to localities and to those who were falling from the social safety nets.

The measures taken by the Obama administration were partially correct but insufficient to offset the shock of financial crisis.

The Bush administration proposed sub-model and that proposed by the Obama administration are characterized by political freedom and economic growth. Both models are based on competitive market mechanisms for allocating resources. If the model supported by Bush is characterized by exclusion, the model supported by Obama is a partially inclusive. The Bush model is a typical American model which is characterized by the exclusion of social cohesion and the solely long-term objective to achieve bigger yields. From this point of view neither the model proposed by the Obama administration is not too different but we must admit that this administration, by some of the measures adopted, has taken important steps towards a social purpose, getting a little closer to the European model of economic growth. The Bush model is based only on the market economy and laissez-faire. Obama administration tried to change this even if not very successful. Perhaps Obama has tried to follow a pragmatic approach making a realistic compromise between existing political forces. However the greatest risk in life is to risk nothing and that is just what Obama has done. On the other hand the Bush model fails by risking too much, playing everything on one hand, the invisible hand.

"The financial sector had its own vision on solving the economic crisis, a more profit-centered vision which calls for the returning to how things were before 2007, to the best extent possible" (Stiglitz, 2010, p. 90). The problem is that US financial companies have come to regard their activity as an end in but the role of the financial sector in an economy is represented by the means to an reach an end, not an end in itself. Thus the US financial sector should be reduced.

2. The crisis of the economic theory

The main problem of economics and economists is that the basic task to deliver accurate predictions and forecasts was not fulfilled. Currently there is a considerable gap between the capacity of the economic science and the reality of the everyday functioning economy.

The current crisis has highlighted the weaknesses of economics, weakness due largely to the fact that economics is a relatively young science when comparing to other more mature sciences like physics or chemistry.

It is abvious that the symbolic economy, represented by the financial markets, doesn't corectly reflect the real economy. This is the main source of the current problems. Any theory that tries to cause a different reality than the one that exists will always lead to a failure.

Any science must be able to challenge its own assumptions. At this time of deep economic crisis challenging the basic assumptions of economics is necessary. It would be fatal to the science of economics to maintain the fundamental assumptions of today. The problem is that the current mainstream theory, established by the classical economists, tells us to wait for the market forces to make their magic and solve the crisis. But the neoclassical theory, which claimed that the markets are perfect, failed. Markets are never perfect and a theory that is based on false assumptions can only lead to some false conclusions. This is exactly what happened and should therefore the economics must be redefined in new terms.

Another problem of the classical and neoclassical economic theory is that wealth is not an end but a means of individual interest. Power can be defined as the possibility to control other people freedoms. Thus came the tendency to identify wealth and power to transform freedom into a something that can be sold. It is necessary to redefine the concept of power. "Hierarchical control of power failed as a wealth generator, hierarchical control of wealth shows signs of failing as long as the access to power is conditioned by wealth" (Dinu, 2011, pp. 1-2). Order in the corporate model is a vertical one with few leading many. It is an oligarchic model. Virtually all the US policies in recent decades have been derived from these concepts.

I think we should return the famous aphorism of Francis Bacon that "knowledge is power". The new society needs to identify power with the term knowledge rather than the wealth. This defines the knowledge society a society based on creating new ideas, innovation, research and development and their application in the economy. The gain comes from the profits that are obtained from the sale of products and technologies when there are placed on the market for a certain period of time. These things are known to all but the innovation did not work properly in the US. At least in the last two or three decades because much of it was directed to financial innovation. They created such complex products that led ultimately to the current economic crisis. The main reason was the flawed incentives, represented by high wages in the financial sector which led to the orientation of human capital, represented by the best students to the field. This is an important slippage that could be corrected by the state, in the short term, by introducing progressive rates of taxation and in the long term by investing in various areas such as research, health and infrastructure.

"The crisis could be interpreted as the result of insecurity and helplessness of the global governance. It is a crisis of behavior in the use of specific means of an economy which becomes global" (Dinu, 2008, pp. 1-2).

We must resume the discussions on the evaluation of the functional relevance of the fundamental principles of global economy, the effectiveness of behavior management system based on confidence in economic policies and reform that cannot longer be without global coordination (Dinu, 2010, p. 344).

Like all markets, the ideas market is not perfect. Not always the best ideas win. Good ideas can be found at the economists who have sought to understand how markets actually work. It remains to see whether these ideas will prevail now in the context of the asymmetric information on this market and the materialistic nature of the various interests represented in the US by large lobbying corporations.

3. The lack of common sense and morality

The promoted model, characterized by the pursuit of profit at any cost, has not created prosperity but instead supported the deficit of morality that we all feel today. When science supports the idea that money is the supreme goal of life the threat of justification the lacking of morality by the actors of the market is born.

Paradoxically, even the economic theory has provided arguments supporting this lack of morality. After all if the pursuit of self-interest leads to society through intermediate invisible hand, that Adam Smith speaks of, everything that an individual must make is to ensure that he/she is following his/her interest. But greed has not led to society good in the latter case of the recent economic crisis, nor in many other cases.

Morality is one of the most valuable human virtues. Morality separation from economics took place when we attempted the orientation of this science to the status of physics. I think this conclusion adopted by economists must be reassessed. Sciences like physics or chemistry study natural phenomena and economics studies human behavior, being defined, by the Austrian School, as the very logic of human action.

The new economy must support and promote morality above individual interests.

4. The new model of economy

Designing a new model of economy is a task as difficult as it is necessary for economists. I think one of the main questions that we must answer is what would be the state's role in this model. The state socialist economics have promoted the total control by not allowing the free pricing mechanism in these economies. Obviously, this model has failed miserably. The opposite of this is the corporate capitalist model, that although it seemed to many that would have won in recent years has started to show more and more signs of weakens.

In the past, the economists have tried and largely succeeded to understand when the markets work well and when not. Mainly this is a question of incentives and motivations. The main situations where markets fail because of the fact that social and private incentives are not well aligned are the cases of monopoly, externalities and informational imperfections.

Thus it was attempted the intervention of the state by adopting antitrust laws to ensure competition, the law on free access to public information and other laws aimed at reducing pollution.

There are many aspects that could be improved. For example, regarding the information imperfections that characterize global financial markets and given the high level of IT technology today, I do not think it would be too hard to find a solution to implement a computer program that enables the potential investors to have more information on what exactly is at the basis of some of these assets. This solution was proposed by author Kamran Dadkhah in his book "The Evolution of Macroeconomic Theory and Policy". The lack of transparency in financial markets is one of the main causes of the current crisis.

Regarding the regulation of financial markets, we can observe that it was not uniform. The credit market, where the players are banks and financial leasing companies, has been heavily regulated (maybe even too much). The rest of the financial markets, especially the stock markets, were far less regulated.

The problem of a too strong regulation is that a strategic mistake of the central administration creates negative effects on the entire system. This happened in the US in the early 2000s, when authorities at that time chose to encourage subprime lending (everyone should be able to buy a house).

The stock market was not regulated at all and therefore various financial instruments have been created so that banks be able to insure themselves against the risk of default. The risk was transferred from one part to another, and those who took it ultimately had no idea of how much is the risk. Financial derivatives should be reviewed and be kept only those that contribute to the smooth running of the economy (eg. those involving insurance against currency risk).

Other roles that a state has in any economy is to ensure property rights and security as well as the necessary infrastructure. On these roles all economists agree. The question is whether it is sufficient and the recent crisis seems to prove that it is not.

Appropriate role of the state varies from country to country and from one era to another. Globalization and new technologies have opened the way for new global monopolies, which have huge financial and political power. Problems created by the separation between ownership and control and the fact that the wealth of many people is managed by other people, allegedly on behalf and for their benefit, proves the need for more effective regulation. In the knowledge based economy of the twenty-first century, the state should assume an extended role in providing fundamental research, that is so important for a healthy and long lasting economic growth, and in achiving social cohesion (which has suffered greatly in the recent decades).

Conclusions

The current crisis has put in difficulty all the economic theories not just to the mainstream ones. Expression of the failure of current theories is given by the hesitation of the current economists and politicians when trying to answer the question: "When and how we will overcome the crisis?"

Today the world ask herself if economics really represents a science.

The successful management of this crisis and the preventions of future problems are related both to the politics and economics.

The science of economics should provide a new model of society in order to rehabilitate. It is deeply irrational to believe that the only solution to stop this crisis is to wait for it to pass. This crisis is the result of ideologies that have failed. This shows that no one has absolute truth and the middle path must always be sought and followed.

A very wrong approach would be to say: we are in this crisis and we have no time to waste by seeking long term solutions to prevent another crisis like because we must focus on the short-term problems and after the crisis to say: if it ain't broke don't fix it.

We ask ourselves if this crisis will really change anything. Of course there are many whose interests are to not change anything essential. But there are increasingly many supporters of the idea that something has to be changed. Change must be a consequence of this economic crisis. The promise of change made Barak Obama win the elections in the US in 2009. Things are beginning to move in the right direction but the question is to what extent the moving speed is sufficiently high to prevent a new crisis. It would be a catastrophe if a new crisis occur in the next 10-15 years because, in my opinion, the world has exhausted the resources for such an unwanted situation and new crisis would lead to very serious social conflicts.

It should be noted that it would be foolish to abandon the current economic model based on market and on laissez-faire and go back to one strictly based on the economic control by the state. We have to invent a new model, more efficient, which combines the advantages of the free market, the entrepreneurship and the defending of property rights at all costs whit maintaining an environment that allows and even promotes social cohesion and social justice worldwide.

We are at the end of a cycle which represents both a great opportunity for the humanity to enter a new era of progress and also very high risk. To do nothing and leave things to chance is not a solution. The future belongs to those who dare challenge it.

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