

THE AMERICAN ECONOMIC SYSTEM – WHEN THE THERAPY LEADS TO FAILURE

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Abstract

The phenomenon of globalization is a subject that has made much ink to flow. The tumultuous economic life led scientists to seek explanations to the negative economic events, events that take many forms, and to whom it is a must to find a solution or even a mitigating factor.

In the past years, the globalization has generated a significant development of the emergent economies, but also that of the level of the developed countries. As it is easy to notice, we are the spectators of an ever more “globalized” world which does not lack numerous risks. Starting with the inequality between the people, continuing with various social problems and ending with the “creative destruction” of some countries’ economies, an inevitable and irreversible destruction after entering into this game, the globalization phenomenon has become a threat.

The globalization has opened, in the absence of economic protective policies, the way of frequent economic crises. The present crisis has taught us that the governments of the countries should play a more active role in the co-ordination of the economic policies, striving to prevent unbalances as those registered already and to avoid crises.

Through this paper, we tried to make a brief analysis on the American economic system, underlying its most important aspects under the economic globalization phenomenon, starting from Joseph Stiglitz’s most recent study and showing that sometimes the therapy can lead to failure, as in the case of United States of America. We also tried to create a little debate on the financial markets fundamentalism issue, talking about the concepts of freedom, political power and wealth.

Keywords: economic policies; political power; freedom; wealth; globalization; financial markets;

Introduction

Starting from the book of J. Stiglitz „*Freefall: America, Free Markets, and the Sinking of the World Economy*”, published in the year 2010 by the publishing house W. W. Norton & Company, one can identify important aspects of an economic system model, proven to be not competitive, reaching a dramatic position, beginning with the biggest world’s economy. This book represents another clarifying study for the present world-wide financial crisis, written by the Nobel Prize laureate for Economics in the year 2001 and former adviser for economic problems during the Clinton administration¹.

From the beginning of the crises there were drawn up many interesting studies concerning the present economic crisis, but Stiglitz certainly remains one of the most authorized voices with regard to this subject. These could be divided two categories – one that presents “*internal*” aspects, focusing upon the decline or salvation of various financial institutions, such as the book of Andrew Ross Sorkin, “*Too Big To Fail*”, or enlarging the area of analysis of economic theories representing the basis of the present economic system proven to be not competitive, identifying the causes and offering possible solutions that could avoid the repetition of the same mistakes. In this last category are included the works of Stiglitz, mentioned before, and John Cassidy, “*How Markets Fail*”².

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¹ Joseph Stiglitz is the laureate of the Nobel Prize for 2001 for economics, president of the Council of Economic Advisers, vice-president and chief economist of the World Bank, teacher at Columbia University.

² Cassidy, J. „*How Markets Fail: The Logic of Economic Calamities*”, Farrar, Straus and Giroux, New York, 2009.

The title of this study, „Freefall” is one very well chosen by the author, because it includes two key words of the economic theories: **“free”** – the equivalent for free, freedom, one of the most precious assets of a person, but also **“fall”** – collapse, that can be considered as one meaning recession or decline in economic terms. This combination **“free fall”** or, why not, „decline caused by the excess of freedom” are particular metaphors helping to identify and characterize what it is happening with the American economic system.

Making an incursion into the domain of physics, an object in free fall is under the influence of a single factor, i.e. the gravity. In the absence of a force that could stop or damp the fall, nothing else prevents the collision with the soil. Moreover, the speed of an object in free fall increases as the object approaches the earth. We could say that the absence of an intervention or an inefficient intervention in the economies being in free fall leads to nothing else but disaster.

An American lead writer, Eric Falkenstein, says that the subtitle of the Stiglitz’s work should be sooner “why the free markets are like the religious fundamentalists”³, being given the author’s affinity with the expression “market fundamentalism”. In the book one can remark the critics of the present capitalism, this being a concept explained by Stiglitz through the term of **“free market”**, a market which is in free fall, in an extreme decline. The present article is only an invitation to read Stiglitz’s book, in order to understand the origins and the causes of the present crises and to overcome the barrier of the unknown with regard to a not competitive economic system.

“Freefall” – main ideas

Stiglitz’s book identifies the origins of “The Big Depression”, intensely criticizes the policies initiated in order to cope with it and offers alternative remedies for future policies that could better handle a crisis from its early signs. What the book has in common with many other studies, written upon the same theme, is the acknowledgment of the fact that the American economic system is in collapse, it stopped being competitive, and can be fixed only by examining the theories upon which it is based. Because until now these theories have not been the subject of a serious debate, this has led to what the author describes as “bubble capitalism”⁴.

There are some aspects which Stiglitz shares with other authors concerning this subject. One of these is the effect that the 30 years of dependence upon the economic theories of the free market⁵ (market fundamentalism), had upon the whole American economy, in contradiction with the lessons taught after “The Big Depression” of the 30’s. Another aspect is represented by the “re-arrangement” of incentives in the financial services of the economy, incentives that have prioritized the short term performance, over the reaching of long term social objectives. Another one is the political power that the industry of financial services exerts upon the carrying out of the economic policies, but also the inherent conflicts of interest, which such a power places above other various challenges and with which nor the legislative or the executive power has been confronted until the present crisis. In other words, all of the above mentioned aspects have represented, and certainly still do, challenges of the American economic system, unheard-of and difficult to meet given that the executives have not the necessary desire to do so.

If we would make an historical analysis of the economic policies embraced by the American government leaders starting with “The Great Depression”, we could learn a lesson that, through a late understanding, would underline the nature and the causes of what one could name as an extreme failure of the market.

³ Stiglitz’s *Freefall* By Eric Falkenstein Mar 3, 2010 (Author’s Website: The subtitle should be “why free market types are like religious fundamentalists”, because he loves using the cute phrase ‘market fundamentalism’ the way MSNBC uses the phrase ‘tea baggers’).

⁴ Joseph Stiglitz, „*Freefall: America, Free Markets, and the Sinking of the World Economy*”, W. W. Norton & Company Ltd., Castle House, London, 2010, pag. 26.

⁵ Concept created by the School of Chicago, used especially under the Reagan administration.

In the next paragraph can be identified the extreme failure of the market: „The United States will have regulation, just as government will spend money on research and technology and infrastructure and some forms of social protection. Governments will conduct monetary policy and will provide for national defense, police and fire protection, and other essential public services. When markets fail, government will come in to pick up the pieces. Knowing this, the government has what it can to prevent calamities. [...] In America, too many of the rules were set by and for those from finance, and the referees were one-sided. [...] Can we expect even to restrict the banks from engaging in excessively risky behavior?”⁶

The above paragraph is essential in analyzing the American economic system. As we can notice, there are some key words underlined, precisely for a better identification of the causes leading to this extreme failure of the market. By his critic attitude towards the adopted economic policies, Stiglitz denounces the present capitalism, militating through his book in the favor of rethinking this economic system. This is done across the entire contents of the book, where it is presented as a speculative non competitive system, based upon commissions and speculation.

Even the rules of the monetary policy are put into discussion, rules that for the most part are made by and for the people in financial industry. In other words, the author’s critics with regard to the carrying out advantageous economic policies for the financial domain, underlines an error of the economic system, which is not based exclusively upon the finances. We could notice the author’s attitude concerning the fundamentals of the real economy. According to the presented elements, the focus has to be moved from the monetary policy to the real economy. It is difficult to change an economic system, but is much easier to try changing the theories on which it is based, therefore it is absolutely necessary to return to the drawing board in order to succeed an adequate rebuilding/correction of the system.

“Today, the challenge is to create a New Capitalism. We have seen the failures of the old. But to create this New Capitalism will require trust - including trust between Wall Street and the rest of society. Our financial markets have failed us, but we cannot function without them.”⁷

The present capitalism has to be dismantled, but the creation of a new capitalism, although it is a challenge and a necessity, is supposed to have trust as a fundament, trust in its economic system. The critic of the financial system is severe and, although the financial markets have betrayed our trust, they remain necessary for the operation of the New Capitalism. The financial markets have failed, but the fault was of those who established the rules, i.e. those who carried out the economic policies, and the fundament of this economic system was a wrong one.

Stiglitz criticizes the financial system, but goes further with regards to the inability of the markets to function properly and to correct themselves. No supporter of capitalism and partisan of the role of the invisible hand can “advocate that the surrogate capitalism – reached in the United States could be one efficient or correct, or one leading to the wellness of society”⁸.

Another important aspect is represented by the critique of the American system, which is based upon speculation, high commissions, a Wall Street critique, a critique of the Bush administration, and even a critique of the Obama administration. Much more valuable is the idea of recession of freedom, a decline of this right, a violation of the American people’s right to be free. This economic system has generated overpaid bankers and brokers, rewarded for their mistakes, that fed and generated additional needs for the American individual (by offering him/her credits, even when he/she was not eligible), violating his/her freedom and transforming him/her from a free

⁶ Stiglitz, J., „*Freefall: America, Free Markets, and the Sinking of the World Economy*”, W. W. Norton & Company, London, 2010, pag. 97.

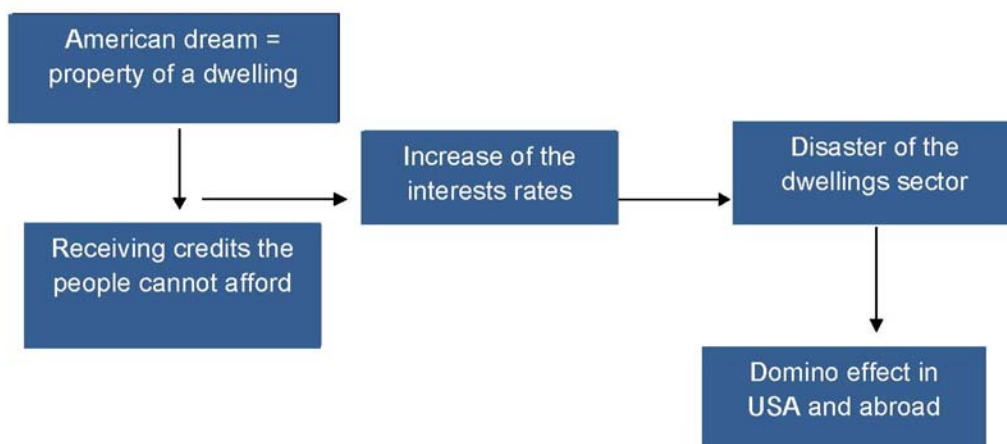
⁷ Stiglitz, J., „*Freefall: America, Free Markets, and the Sinking of the World Economy*”, W. W. Norton & Company, London, 2010, pag. 94.

⁸ Stiglitz, J., „*În cădere liberă, America, piața liberă și prăbușirea economiei mondiale*”, Editura Publica, București, 2010, pag. 325.

individual into a person chained up in the economic system, a slave of the banking system based upon speculation and huge commissions.

Therefore, the giving of toxic mortgage credits, credits given to persons not fulfilling the crediting conditions, credits secured through their transfer to foreign investors, in order to share the risks and obtain a better absorption, have led to the collapse of the American economic model, based upon speculation. Its basis is presented in the Figure 1.

Figure 1 – The failure of the economic model based upon speculation and deregulation

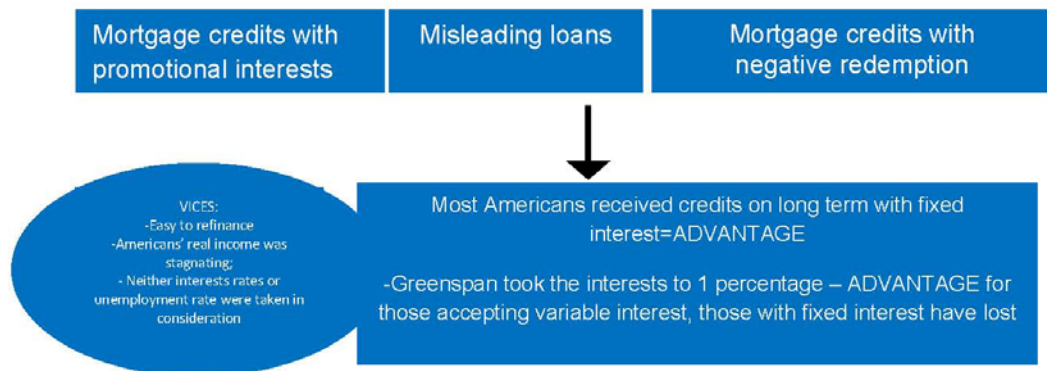


Source: Joseph Stiglitz, „*Freefall: America, Free Markets, and the Sinking of the World Economy*”, Chapter 4

The lack of professionalism among credit brokers, who presented and faked data concerning the applicants' incomes, with the purpose of meeting the crediting conditions, the applicants' lack of information with regard to the risks they took by soliciting said credits, the banks succeeding to create needs and desires many of them didn't have, the bankers' lack of professionalism and greed, plus the absence of regulation to maintain the economic stability, represent the “parasites” that “have infected” the financial markets of the American economic system.

All of these have represented negative instruments leading to this “free fall”. They are presented in Figure 2:

Figure 2 – The mortgage swindling – characteristics



Source: Joseph Stiglitz, „Freefall: America, Free Markets, and the Sinking of the World Economy”, Chapter 4

The markets represent the vital centre of a successful economy, but they must not be left free, and the State has to play a regulator role, particularly for preventing situations such as those already occurred. “Perhaps Adam Smith was not completely right when he said that the markets lead the society, with an invisible hand, towards prosperity. But no defender of Adam Smith would dare to say that surrogate capitalism – reached in the United States could be an efficient or correct one, or leading to the wellness of society.”⁹

Many times in economic studies, an association between the political power and the economic one is present. An economic system and the political power have to be in a tight relationship, a balance, precisely for succeeding in maintaining stability. Unfortunately, in U.S.A., this balance has been broken, which has also spread beyond its borders. The globalization phenomenon has emphasized this unbalance.

The unbalance means a state opposite to order. An unbalance represents a state of uncertainty, where one of the economy components becomes inefficient, although on the surface it seems to be very beneficial to the economy, it is a state of maximum vulnerability for the economic system. In the U.S.A, this unbalance has been created by the “vulnerability” of markets, by the lack of their regulation. The financial markets seemed to be very productive, bringing benefits and growth, but the fundamentals were wrong, they were “corrupted”.

“The American Empire” is an economic system, that before the crisis, offered credibility, precisely because the U.S.A. were the first economic power in the world. Nobody doubted the U.S.A.’s capacity to manage the risks, but it wasn’t so. The risks have poorly managed, the models were wrong, and obtaining a large sum of money within the shortest period of time, was the main objective of the agents. The globalization has imposed a very high rhythm of adaption to various economies.

The present crisis has demonstrated that irrespectively of the size of the economic system, even that of an empire, the unbalances occur and develop, if there is not a tight connection between state and the economic environment. This crisis demonstrates that both models, the Anglo-Saxon

⁹ Stiglitz, J., „În cădere liberă, America, piața liberă și prăbușirea economiei mondiale”, Editura Publica, București, 2010, pag. 325.

one, based upon “laissez-faire” and freedom of markets, and the European one, of the welfare/social state, proved to be imperfect, limited and crises generators.

Many authors have written about the existing crisis, but few of them have also offered solutions from the theoretical point of view, not only the practical one. For example, in his book “*Economy of crises. Flash course about the future of finances*”¹⁰, Nouriel Roubini, says the economic system needs a new essence, even a new economic model. The proposal made by N. Roubini is based upon a model of market economy, where the government provides the necessary public services and where a “healthy” prudential monitoring of the economy and of the financial system exists.¹¹

Stiglitz and Roubini share common ideas with regard to the economic system based upon a corporative capitalism. Roubini also sustains that this present capitalism should be changed radically. Analyzing the ideas of both economists, one can say that Roubini has a more critical attitude than Stiglitz, he wants a radical change of the system, while Stiglitz wants a return to the fundamentals of the economic theory, that favors the rebuilding of a New Capitalism.

The crises are benefic, because they bring changes in the area of policies and especially in the one of ideas. If Roubini says that a crisis should not be wasted, Stiglitz bring concrete arguments, mentioning that if the right decisions will be taken, the effects of the crisis will be diminished and a new crisis will be avoided. If the taken decisions are wrong then the society will have the most to suffer, dividing itself even more, with the economy becoming more vulnerable, lacking any order.

The critiques brought by the author to the economic system are:

- ✓ lack of regulation concerning the issuing of toxic credits;
- ✓ deregulation done in such a way as to easily allow bankers to issue toxic credits;
- ✓ counteracting the persons kept responsible for solving the problems within the financial industry;
- ✓ the adoption of some inadequate measures, like the reduction of the interest rate to one percentage, which lead to a speculative bubble;
- ✓ the incompetence of the banks in estimating the risks;
- ✓ the conservators’ attitude, according to whom the State shouldn’t be involved in financial activities to help the population.

The remedies offered are concrete ones, resulting from Stiglitz’s especially critique attitude with regard to the economic system:

- the financial bailing of the loans givers, as way of controlling the forced executions;
- solutions in favor of population – for the salvaging of dwellings – without bailing out the crediting banks which should be forced to support the consequences of the fact that they didn’t properly estimated the risks;
- solutions to support the population to return the loans;
- loans from State with a very small interests or even zero for putting at the population’s disposal a not so expensive credit; this should be translated in a gain for the State and the population, but not for the banks;
- the State should maintain a full employment and a stable economy, promote innovation, provide protection and social insurances and prevent abusive exploitation¹².

¹⁰ Roubini, N., Mihm, S., „*Economia crizelor. Curs fulger despre viitorul finanțelor*”, Editura Publica, București, 2010.

¹¹ Roubini, N., Mihm, S., „*Economia crizelor. Curs fulger despre viitorul finanțelor*”, Editura Publica, București, 2010, pp.9-15.

¹² Stiglitz, J., „*În cădere liberă, America, piața liberă și prăbușirea economiei mondiale*”, Editura Publica, București, 2010, pag. 326-331.

Conclusions

Before acting, the economists should rethink the fundamentals of the economy and to ponder on the correctness of the economic theories. We are witnessing radical economic changes, the end of certain economic cycles.

The used pretext, namely the Stiglitz's book, shows that if not kept under control, this unbalances will generate other mutations, even more serious ones. The substantiation of some correct ideas is important, learning lessons from crises, because in time the crisis will disappear and only its consequences will persist. "The battle of ideas" represents our legacy, a diary which we may have to open again anytime, because the market economies are in a constant change and a continuous struggle.

The ideas presented are only some among the most important ones with regard to the American economic system, an empire which right now is unbalanced. The main idea brought in debate is that of "dismounting the present capitalism", and returning to its fundamentals in order to rebuild a new capitalism based upon trust. The key words, such as power, order, globalization, fundamentalism of the markets, freedom, are cleverly used by J. Stiglitz in his approach with arguments. These key words represent forgotten values or used in a distorted way by the American type of capitalism, a thing that has created a clear unbalance, its result being the "free fall" of the entire economic system.

The present crisis offers with no doubt one of the most useful lessons about a dynamic world that fails too frequently, and should make aware both the ordinary citizen and the deciding factors of the economic policy about the risk of getting prosperity at any cost.

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