Constructing a New Global Economy after the Global Financial Crisis : Stagnation and Social Crisis or Towards a Green Economy and Global Freedom?

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Abstract:

The global economic crisis of capitalism is far from over. The historic electoral victory of Barak Obama created high expectations of progressive change in the US and the world. As a president Obama certainly has shown some courage with a vision and the same organizing capacity that helped him score his unprecedented victory. The 787 billion dollar stimulus package, in spite of all the earmarks, was still a sign of Obama's determination to do the right thing. But after winning in 2012,how far is Obama willing to go? Or, more to the point, does he understand the deeper reasons for the fix the world is in? Unfortunately, the answer to the first question is, not very far, and the answer to the second question is that his understanding is quite shallow. I argue that nothing less than a global new deal will get the world economy out of the current crisis. In order for this to come about a new global social democratic movement for deepening economic and political democracy is necessary.

JEL Classification: F3, F6

In this essay, I discuss the following two books and then use this discussion as a background for analyzing the nature and consequences of current crisis and a green path to long term recovery.

End this Depression Now! By Paul Krugman, New York: W.W. Norton 2013

The Servant Economy, By Jeff Faux , Hoboken, NJ: John Wiley 2012

Most importantly, my analysis will point toward what Abraham Lincoln called the need for "disenthralling" of the American and European leaders and citizens from many modernist and imperialist illusions.

The story of the recent crisis has already been told many times. Yet no one has put the case for fiscal policy measures more forcefully than Paul Krugman. After reading the book from cover-to-cover, one has to agree with Krugman's assessment.

Despite the initial bafflement as the world economy was hit by the biggest financial crisis since the Great Depression, by now there is broad agreement on the underlying causes of the crisis: banks and financial institutions indulged in excessive leverage and excessive risk taking while regulators did not provide an adequate regulatory framework. In the US, the proximate causes also included the Fed policy under Alan Greenspan of supporting an artificial housing boom after the bursting of the stock market bubble through low interest rates and lax regulations in the housing and financial sectors in particular. Through various channels, the crisis was transmitted to other sectors of the economy and to nations across the world, leading to significant human development impacts on the poor and vulnerable. As the "Stiglitz Commission report"(the Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System), among other sources, emphasizes, the deeper causes relate to historic reversal of post-depression checks and balances of national and global economic governance.

As the Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System put it:

> "…the standard policy nostrums—that countries should have sound macroeconomic policies strong governance, transparency, and good institutions – may be less than helpful. Countries that held themselves out as models of best practices have been

> shown to have had deeply flawed macroeconomic policies and institutions and to have suffered from major shortfalls in transparency."

Against this backdrop, there have been many calls for changes in the global financial and economic governance architecture that would lead to a more stable and less risky international financial system. For example, internationally, there is momentum around BASEL III, a package of proposals to strengthen global capital and liquidity regulations. The United States government and various EU countries had introduced legislation aimed at reforming financial institutions under their jurisdiction.

Krugman's book plays on many registers---from the domestic scenes of economic incompetence to the European crisis and the tragedy of the "Austerians".Krugman has deftly welded together the policy mistakes and tentativeness of Obama's moves with the tragedy in Europe.

In thirteen beautifully written chapters with a postscript the book covers a vast amount of actual research and critical scholarship. As a great neoKeynesian political economic theorist who has written about many contemporary issues, Krugman demonstrates his grasp of the theoretical mistakes along with his mastery of empirical details.The contemporary economic and political historical scholarship displayed in these pages have great theoretical reach and depth as well.

As Krugman himself explains, describing both his research and his humanity:

So here we are, more than four years after the US economy first entered recession----and although the recession may have ended, the depression has not…..Tens of millions of our fellow citizens are suffering vast hardship, the future prospects of today's young people are being eroded with each passing month----and all of it is unnecessary.

For the fact is that we have both the knowledge and the tools to get out of this depression….we could get back to full employment very fast, probably in less than two years.

All that is blocking recovery is a lack of intellectual clarity and political will.And it's the job of everyone who can make a difference, from professional economists, to politicians, to concerned citizens, to do whatever he or she can to remedy that lack. We can end this depression---and we need to fight for policies that will do the trick, starting right now. (pp. 229-30)

It is important to remember this when reading Krugman's book. He has done painstaking contemporary historical research; but he does not pretend to be looking at these events with some artificial scholarly objectivity. Rather, what he shows is a kind of moral objectivity that celebrates the struggle of freedom for ordinary citizens because this type of moral and economic realism can offer arguments for the existence and validity of freedom for the citizens of our world. More importantly, freedom is a human concern and all humans regardless of their origins, race or gender have an equal moral capacity for freedom. The tragic irony is that the moral turpitude and intellectual cowardice of the policy advisers and politicians may be opening the doors to great instability and unfreedom in our world. This is the kind of morally relevant economic analysis that Krugman, Amartya Sen and many others including the present writer practice and defend.

Jeff Faux pushes these themes much further by focusing not just on short term fiscal policy issues but mainly on a complex set of issues related to the economic decline of the middle class and the erosion of democracy in America. As Faux perceptively points out, a careful look at the evolution of the US economy since the 1970s can give us an insight into how much underlying conservative preconceptions---often not even articulated since these are taken to be common memories and common sense---and certainly never criticized, continue to dominate scholarship shaping our intellectual disciplines and our assessment of economic wellbeing in America. Faux ably questions such prejudices. He does so with both great intellectual rigor and coverage of contemporary research.

Chapter one sets the groundwork and describes the sharp decline of living standards for ordinary Americans. It also points out the "March of folly" in American policy making. It criticizes with a note of urgency the self-deception of many Americans and the deception of the middleclass by the ideologues of the wealthy. Faux declares poignantly:"hope is not a strategy".(p.8).

The succeeding chapters lead the reader through the history of the erosion of the economic cushion for the middle class.As the book uncovers with great care, this decline has been hidden from view by a well orchestrated ideological campaign by the right. However, the follies discussed by both Krugman and Faux have led to a great despair and both right wing tea party movement and the left wing occupy wall street movement. Faux does point out the naivete and disorganization of the left and the opportunism of the democrats remorselessly.Because he also leads the reader through a deep analysis of the causes, this exercise is not as heartless as it may seem.

The book well repays the patient reader with numerous insights. But for the present reviewer, the last chapter (chapter 12) is the most inspiring of all. This chapter begins with the trenchant critique of the American governing class and its unwillingness to change things. But it ends with a realistic political agenda the centerpiece of which is a longterm movement for a constitutional amendment to limit campaign spending and also prevent private corporations' domination of public life in America. Launching such a movement will be hard; but so are the realities all over the world. If the world is to recover from economic and political decline deepening of democracy is the only realistic option. Tepid, halfhearted moves will not lead even to temporary recovery, as Krugman points out. The rise of right wing populist movemnents in the US and Europe will present a real danger of fascism and barbarism.

Both these books perform exemplary tasks by analyzing the looming dangers and offering ways of saving global capitalism from itself. With these books as the background I will now discuss the deeper aspects of the current situation and a possible way out.

The global economic crisis of capitalism is far from over. [1]The summits that are still being held periodically and the buzz from the finance ministries of the G-20 are further pieces of evidence that the leaders of the global capitalist system are shaken by the unexpected depth and breadth of this crisis. Yet they are seemingly powerless to do anything. What are the lessons ordinary people from all over the world should draw while business and political leaders ponder their own course of action?

[1] For other references, see Alonso and Ocampo. 2012),Cornford(2013) , Demirguc-Kunt, , Detragiache and Merrouche. (2010), Eichengreen (2012), Eichengreen et.al. (2012). Grabel(2010). Ocampo et. al. Griffith-Jones , et. al.(2010;2012), Khan(2004;2006;2011;2012;2013) Lin et. al.(2008), Ocampo (2006), Stiglitz(2010), UNICEF (2010), United Nations (2009).

The historic electoral victory of Barak Obama created high expectations of progressive change in the US and the world. As a president Obama certainly has shown some courage with a vision and the same organizing capacity that helped him score his unprecedented victory. The 787 billion dollar stimulus package, in spite of all the earmarks, was still a sign of Obama's determination to do the right thing. But after winning in 2012,how far is Obama willing to go? Or, more to the point, does he understand the deeper reasons for the fix the world is in? Unfortunately, the answer to the first question is, not very far, and the answer to the second question is that his understanding is quite shallow.

After decades of arrogant abuse of political, military and economic power, the US in particular faces an uphill task to undo the errors of the past and to build for a better future for all. I begin this part of my essay with a look at the economic challenges facing us and how we got from the euphoric 1990s to the abysmal 2008-9. The good news is that with determination and a genuine flowering of democracy here, and with the discontinuation of US imperial strategy abroad, the present crisis can be addressed from a long run perspective of creating a prosperous, sustainable green economy. This transformation can begin with a green public investment program and a disengagement from imperialist practices abroad.

How We Got to the Current Global Financial and Economic Crisis

It is important to realize that the roots of the crisis lie in the rampant play of the free market forces that were unleashed long before the Bush administration started to carry out its particularly open attack on the US working class along with irresponsible financial liberalization. Of course the misadventures in Iraq and Afghanistan together with the failures of the neoconservative agenda make the policies of the Bush administration stand out as truly and arrogantly misconceived. But the Clinton administration also did not stand in the way of dismantling the remaining financial safeguards from the New Deal era. Politically, it also pursued a neoliberal imperialist policy abroad.

Several political and economic factors contributed to the current depression and global instabilities. The relative decline of the US political and economic power in the 1970s led to the dismantling of the postwar Bretton Woods system of fixed exchange rates and global management of the World Economy through the IMF and domestic policies for growth in the member countries. IMF itself was transformed from an agent of maintaining global economic stability and prosperity to a dogmatic enforcer of neoliberal policies in developing countries. The room for discretionary macroeconomic policies for demand management and the creation of full employment shrank drastically. The draconian package of contractionary policies was presented as a recipe for expansion of these economies in an ironic and cruel gesture. In fact, the economic rhetoric was a cover for opening the vulnerable developing economies for further exploitation by the US, European and Japanese capital---finance capital in particular--- and their junior partners.

The successes of the 80s in forcing this anti-people imperialist agenda led the US policy pundits in particular to believe that a deregulated, largely privatized economy could be sustained indefinitely. The stock market booms and accumulation of private wealth at the top seemed to be proof of the efficacy of these ill-conceived policies. The dismantling of public institutions of economic management coupled with the ideological incantations of the virtues of the so-called free market led to a smug acceptance of the kind of situation that prevailed before the great depression of the 1930s. Alan Greenspan's gamble of easy money policy by the Fed to save the real estate market in the US from collapsing eventually resulted in the subprime debacle. The rest, sadly, is now all-too- recent history.

Where We are Now

The United States and the rest of the world are still on the brink of a depression as Krugman correctly and bravely(for an economist) points out --- even with a tepid recovery--- one that may last for years unless the governments around the world---particularly the US--- take decisive action to overcome the current conditions. With effective public policy the conditions could be mitigated so that it does not turn into the massive financial meltdown and economic disaster like the Great Depression of the 1930s. However, the collapse that is already upon us could potentially be just as devastating unless rapid and thoughtful steps are taken. In the rest of this essay, I discuss the problems from a US point of view for the simple reason that US policies are largely responsible and without correct policies by the US, the rest of the world will not be able to get out from this debacle very soon. But I want to emphasize that global cooperation will also be an important building block in the years to come beginning right now.

The official unemployment rate in the US is still very high and in Europe it is higher still.It should be pointed out that the official unemployment rate is derived by ignoring some important factors such as the differences between part and full time work, discouraged workers who have dropped out of the labor force etc. The overall effect is to understate the true unemployment rate which may already be over ten per cent in the US and close to 20 per cent in many parts of Europe.

Many of the major nonfinancial corporations have continued with substantial layoffs. The potential consequences, especially for the less affluent and the young, would be severe enough--a long interlude of sputtering stagnation, years of tepid growth and stubbornly high unemployment, punctuated occasionally with a renewed recession.

To use a homely metaphor, depression means an economy stuck in a ditch that cannot get out on its own powers. Therefore, without public intervention the economy is unable to begin the process of expansion. Japan, the second-largest economy in the world in 1980s and 90s, was in this condition for roughly twelve years, following the collapse of its own financial bubble. If the United States falls into the same type of crisis, it will affect not just its own economy but the world economy will be in great danger as well. This is because the US market for imports and its huge trade deficits keep the world economy growing in this age of globalization. At the same time, the global imbalances are putting the pressure on dollar to be devalued at some point---although because of the global depression and the search for safety dollar may appreciate in the short run. In the medium to long run, this, of course, puts those countries financing the US budget and trade deficits in an awkward position. They stand to lose a great deal of the value of their dollar-denominated assets if a dollar crisis materializes. For many economists it is really not a question of “if” but “when”.

Although nobody knows with certainty whether an even deeper global depression will happen if nothing much is done, the consequences of waiting to find out could be horrendous for everyone. When the US economy corrects for its excesses, it is always the innocents who are led to the slaughter first. Even if the odds are small that the worst will happen---and in this case the odds have been increasing----, it seems reckless to gamble. Taking strong measures now would save both the US and the world economy from a possible meltdown. A depression can be read as a "market signal" of a dysfunctional economy that requires fundamental restructuring. Japan learned this the hard way. In the present case, such a signal may be flashing the need for deep changes both in the economic system in the US and the world economy. Surely it is not too soon for us to ask what might be wrong at a deep structural level and how to correct things before it gets much worse.

It is now widely acknowledged that the Paulson plans from the treasury did not work in creating a real economic recovery. For many months, Paulson dismissed the growing anxieties expressed in financial circles. Moreover, he paid no attention to the real economy. Now that we are experiencing negative growth and a real prospect of deflation, jumpstarting the real sectors of the economy has become the key issue. This is what Obama’s recovery package is meant to accomplish. Similar logic is at work in The European, Japanese, Chinese and other recovery packages. Everybody who ubderstands the arguments of Krugman and Stiglitz---as well as the present author--- seems to realize that expansionary fiscal and monetary policies must be used.

But in times of deflation, monetary policy is like pushing on a string. Nothing much can happen until business confidence is restored. But at least the Fed is doing something. To complement this and offer further stimulus, Washington's elected politicians are now making the major fiscal effort that is required. However, a democratic public debate on this subject matters. Without a full and in-depth public airing of the policy issues, there is no way to develop the political foundation for undertaking large and controversial measures on a long-term basis.. If Washington responds tentatively with cautious half-measures, as Japan's government did for many years, then the results for us may look a lot like Japan.

To put it bluntly, what was under way in 2008 was a brutal unwinding of the delusional optimism that reigned during the 1990s and the first six years of this century—excesses like the hyper bubble in financial assets and real-estate that led investors and companies to wildly overvalue their prospects for future returns. The stock-market bubble was the most obvious expression of excess, but not the most serious dimension. In an era of Internet fantasies and collective self-delusion, business sectors (and their financiers) overinvested on a grand scale and generally used borrowed money to do so. That is, they built too many factories, shopping centers and office buildings--creating more productive capacity than even the credit-fueled demand in the marketplace could possibly absorb. Consumers indulged in their own version of wishful thinking, borrowing heavily to keep on buying, hoping the "good times" would last long enough to bail them out. This legacy of accumulated excesses lies across the American economy like a thick miasma--overcapacity in production, overpriced financial investments, mountainous debt burdens for corporations and households. All this has resulted in a deepening reluctance to invest or to consume.

Personal debt now far exceeds disposable income. Manufacturing is operating far below its productive capacity, greater idleness than during the 1990-91 recession and approaching (some would say it has already exceeded) the severity of the 1982 recession. For producers of semiconductors and related electronic components, capacity utilization has fallen to below 70 percent. In telecom equipment, it is even lower. That's why there is so little new investment. What company is foolish enough to build new plants when so many existing ones are shuttered? And who would lend them the capital with the financial crisis raging now? Now that consumers have run out of capacity to borrow more and can no longer refinance home mortgages, the collapse of aggregate demand has become far worse. The US economy is unlikely to recover its full vigor until this dead weight from the past is substantially reduced. In the meantime, the struggle of companies (and other countries) to dump their excess production by selling cheap, while also shrinking jobs and workweeks, threatens to make things still worse, eventually landing the world into a general deflation. The broader meaning of deflation, however, is that assets of almost every kind, from financial investments and real estate to manufactured goods and commodities, are revalued downward steadily. This is only the inevitable correction for the falsely optimistic upward asset valuations during the boom years. The overvaluations, in the United States caused global damage because the bubbles were transmitted worldwide through trade, portfolio investments--- particularly securitization of subprime loans and the hyper active energies of global investing. The development of a largely unregulated derivatives market added much fuel to this destructive fire of global finance.

The logic of the current and immediate past interventions can be described briefly. In broad terms, the government has the power to intervene on three fundamental fronts to improve the economic conditions.

First, the Federal Reserve can deliberately induce price inflation to counter the deflationary forces and excite what Keynes called the "animal spirits" of business leaders. Rising prices will also automatically ease the debt burdens of borrowers by diluting money's real value (that's why creditors always adamantly oppose inflation).

Second, Congress and the White House can simultaneously launch a major stimulus program composed of public spending and quick-acting tax cuts, thus running up far larger budget deficits than the Bush Administration has engineered. Whether the money builds schools and highways or hires more schoolteachers, it creates new jobs, incomes and business activity.

Finally, if these steps are insufficient, the government may have to intervene more directly and manage a substantial liquidation of debt burdens--either arrange ways to write off failed loans (as it did in the savings-and-loan crisis of the 1980s and to some extent, more recently during the current crisis) or create more lenient terms for the indebted companies and households, much like a banker's "workout" for a financially troubled firm. This, too, some extent has already happened.

The alternative--doing nothing—will have meant allowing events to take their own course toward the self- destruction of a complex economic system. "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate," Andrew Mellon advised Herbert Hoover after the 1929 crash. "It will purge the rottenness out of the system."

Such advice is surely a counsel of despair. As John Maynard Keynes explained in the thirties, the government can get the money moving again by borrowing idle wealth from the private sector and spending it or distributing it to taxpayers. The Fed can also inject new money into the system. This will result in further spending--- a multiplier effect--- and will stimulate further economic activity. Therefore, right now, federal deficits are an essential element of the solution--very large deficits to the tune of 800 billion dollars or more if you intend to jump-start a $14.4 trillion economy. Yes, borrow-and-spend therapy increases the national debt, and more of it is held by people abroad than before but the alternative of economic chaos world wide is singularly unattractive.

Showing commendable foresight (or perhaps hindsight as well) president Obama is urging further action. In terms of this three-pronged crisis prevention, the Federal Reserve has already shown an awareness of what may be required of it. To underscore the commitment, Bernanke said the Fed would be prepared to use unorthodox tools to expand the money supply if short-term interest rates (already close to zero) can be cut no further. Instead of buying only short-term Treasury notes to inject new money into the economy, the central bank may purchase long-term US bonds or foreign bonds. It may accept corporate debt, private bank loans and mortgage securities as collateral for the Fed's direct lending to banks--a way of pushing bankers to lend more generously to business. In fact, the Fed has far broader powers inherited from the Great Depression--the ability to make emergency loans to private businesses or state and local governments in extreme circumstances.

If things deteriorate further, the government's deficits may have to grow even larger to become effective. While the political climate is ripe, forward-looking progressives should be drawing up a good list of projects to strengthen the economy in the long run as well. Among these are: repairing the tattered infrastructure and launching innovative public investments in renewable energy and sustainable green community development that speak to the future. If the money contributes to real improvements for economic infrastructure, it will benefit all for a long time.

The good news is that the money spent on green development projects will create more jobs than other investments. By using a social accounting matrix for the US, we estimated that more than 22 jobs will be created by spending an extra one million dollars on green public investment projects. By contrast, even progressive, non-military projects at best create approximately 15 new jobs per million dollar expenditure. Of course, military-industrial complex creates even fewer jobs---fewer than 10 for every million dollars of added expenditures. The third avenue for dealing with the crisis--reducing the mountainous debt burdens on families and businesses--is a far more controversial challenge and fraught with the potential for insider favoritism.

Frankly, much more needs to be done to help the ordinary people. Rescuing the big players while allowing others to drown has been the conventional approach in recent decades, including the financial firm bailouts engineered by the treasury. But a lively political debate might inspire broader remedies that are both more equitable and more effective. Just as the S&L bailout fifteen years ago aided major financial players, government could create a "resolution trust corporation" for people--an agency that supervises debt workouts for households, gives them more time to catch up with mortgage and credit card payments, and imposes these relaxed terms on the financial industry, with government guarantees against failure. That would represent stimulus with a democratic purpose. So far, we have seen one sector after another line up for emergency bailouts, and the government picking winners and losers, defending politically influential elements of the status quo in the name of protecting the soundness of the system. A progressive economic policy package now means facing up to some long-suppressed truths. Several successive US regimes have championed a corporate-led globalization, which has been good for US multinationals but not for the general public. Therefore, the even larger reality is that the crisis of the US economy signals the need for a deep restructuring of globalization as well.

The globalized system the United States launched and protected throughout the cold war decades approaches its own reckoning with the dilemma of too many factories and not enough buyers. Escaping this condition will require difficult diplomacy (made more difficult by the Bush Administration's naked imperialism), but the risks are historic in dimension (the global trading system disintegrated after 1929 as worldwide depression led nations to protect their own producers and markets from foreign competitors). A cooperative solution requires that leading nations must join to launch worldwide stimulative policies.

The fundamental solution, however, involves the kind of moderating reforms advocated by democratic social justice activists worldwide--rules to rebalance the system and genuinely promote wages as well as output, financial terms that give developing countries more time and space to seek their own distinctive economic strategies, plus new institutions of governance that are truly equitable and democratic, instead of defending the interests of giant corporations. That's a very tall order for statesmanship in a world presently governed by mostly small-minded politicians.

Meanwhile, the economic dysfunction in the American system involves many other contentious questions, including the overbearing scale of certain dominant enterprises. The gathering evidence also suggests that the mass-consumption economy that has flourished since World War II may need fundamental restructuring as well. Solving this problem will also launch us on the path of sustainable development.

The present condition is, of course, related to the gross and growing income and wealth inequalities of the past few decades. But the long-term investment demand for many commodities may also not be there when we have already built too many shopping centers selling cheap imports from China and other low cost production centers. We have also built too many jails, big houses for the rich and golf courses.

This is the time to start investing in solutions to the problems the country has long neglected. There are many economic opportunities. For example, we can invest in the energy technologies and industrial transformations required for the post-hydrocarbons age of ecologically sustainable prosperity. We can invest in healthcare and transportation and production systems to deliver safe, healthy food. We can invest in the smaller, more nimble firms run on cooperative stakeholder governance principles and thus prepared to do things differently. We can and must invest in people--the human development that begins with children at a very early age and good schooling for all at all levels of education. These and other investment opportunities are where the future jobs and higher social returns will be seen.

The people focused on maintaining vested interests and privileges are naturally resisting such shifts in purpose and deploy their political muscle to block any promising departures. But a fundamental restructuring at least would open the way to think of a new world. The old world is dying and if we wait too long, we will die with it. Now that Obama has achieved the “impossible dream” of being the first interracial president of US, it is time to dream anew, to strive for a different kind of politics, to take the first important step of green public investment program to revitalize the economy and galvanize all good citizens for the arduous climb towards an economy which will serve the people. That is the kind of change that the new president and all of us must fight for from now on.

Important as the above economic steps are, without a clear understanding of the domestic political forces and the international political situation, nothing fundamentally progressive can be achieved. We must understand what forces are impeding progress towards a prosperous and free global system that can work for the benefit of all. We must also understand what are the organizational challenges for the progressive forces and how to meet these challenges from now on. While an economist can offer economic analyses along the above lines, it is the task of progressive political scientists to further engage the citizens in a dialogue as to what kind of democratic politics at the grassroots level will be necessary for transforming the current administration into a genuinely democratic regime as the US was for a brief period at least during the first FDR administration. Nothing less

than a global new deal will get the world economy out of the current crisis. In order for this to come about a new global social democratic movement for deepening economic and political democracy is necessary.

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