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Theoretical Models of Economic Recovery in Recession and Depression Phases

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Abstract. In recent years, specialists from many fields (economists, historians, sociologists) discuss intensely the phenomenon of global economic crisis. Discussions are diverse, contradictory and often with strong political charge. The debates generated by this phenomenon mainly focus on two themes: the causes of economic crisis and the correct solutions out of them.

Keywords: crises; free market; invisible hand; neoliberalism; liberalism

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1 Introduction

Views regarding the causes of economic are different among specialists. Thus, those who sought and still seek answers and explanations to what is happening today in the economic world can be divided into two groups: the defenders of free market and another, supporters of state intervention in the economy. Defenders of the free market consider that the market can function freely allowed to self-regulate and the State can only make things worse.

The contrary, supporters of interventionism believes that the free market has failed and sees the state the only tool that can revive the economy.

Events affecting the world economy since 2007, revealed imbalances in the system occurred long time before the onset of economic and financial crisis.

One view, widely shared, is that the U.S. mortgage market turmoil was those that generated the crisis, but such causes are both macroeconomic and microeconomic nature. Excess liquidity, deregulation massive financial deleveraging, all these combined lead to a major crisis. The degree, to which countries, developed and emerging, have been affected economically, depends largely on the weaknesses of each economy and how they are exposed to toxic assets and how they respond to the crisis affected economies depends on macroeconomic policies and the levers that are used.

Specialists in all fields, economists, sociologists, historians and sometimes even people with little economic knowledge for living conditions are becoming more difficult, they ask whether these economic shocks can be avoided or at least reduced in intensity.

The causes of economic crises, how these crisis manifest and the undesirable effects of these events have raised several theories by followers of different doctrines such as Keynesian, Marxist, prekeynesiste, liberal. We talk a lot now about Minsky moment and financial instability theory. Even if economic crises, unwanted events, accompanied, historically, capitalist system we cannot agree with the view held by Marx and his followers who support the idea that the occurrence of crisis is specific just this type of system. Experience shows that planned economies have experienced economic shocks which often were hidden.

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2 The "Laissez faire" Model

Due to the complexity of economic phenomena, some economists believe the current economic crisis cannot be overcome by appealing to traditional models. Classical and neoclassical economists argue that guidance to overcome difficulties arising in the contemporary economy can be achieved by spontaneous market mechanisms. Other economists, advocates of Keynesian doctrine assigns the state a decisive role in economic recovery.

Until the greatest crises in history, Great Depression from 1929-1933, the capitalist society promoting a state with their strictly traditional, defense, internal order, according to liberal doctrine, which asserted the principle of self-regulating market without government intervention. The most famous proponent of classical liberal doctrine is Adam Smith (1723-1790) who promote the "laissez-faire" principle. Under this principle, Adam Smith considers that the in conditions of market freedom, individuals through their individual actions, motivated by selfish interests jointly contribute to the welfare of the nation.

In order to achieve better understanding its system of thought, Adam Smith, uses the concept of Homo Oeconomicus. For him, Homo Oeconomicus is, in terms of abstract, free trader characterized by:

a. rationality, natural human feature, which leads the individual to the final goal meaning achieving maximum profit with minimum effort;

b. selfishness (in economic terms), causing the individual to pursue self-interest. Adam Smith is convinced that Homo Oeconomicus has altruist qualities, is endowed with moral feelings. On this feature of Homo Oeconomicus, Adam Smith, in his book "*Theory of Moral Sentiments*", in the chapter entitled "*On sympathy*" says the man "*are evidently some principles in his nature that make him interest in fate of others*" (Adam Smith, 1970, apud Popescu, 2004);

c. Freedom of action is based on the inviolability of private property. Any interference limit with freedom, distance individual rational from purpose goal, from maximizing of profit, and implicitly, from the provide welfare in entire society;

d. performs their work in a perfectly competitive environment;

e. operates in a social environment. Individual could not achieve their goals than under division of labor, establishing relationships with others.

On stage free market, consumers, producers and owners of production factors interact, each seeking to maximize their own satisfactions. Responsibility of an efficient allocation of market resources are income, prices and profits, guided, as Adam Smith showed us, by an "*invisible hand*". Metaphor "invisible hand", invented by Adam Smith, suggests that by developing self-interest, individuals indirectly stimulate the economy leading to increase of wealth. Although Adam Smith accepts a minimum state involvement with the task of determining the fundamental rules for the proper functioning of the market.

Therefore, Adam Smith sees the market as a decentralized coordination mechanism which not requiring state intervention, "invisible hand" fully justifying the "laissez-faire" principle. According the classical school, the ideal model of economic system was one which, under equilibrium conditions, work for themselves, governed by natural laws.

Early classics that were concerned with discovering natural laws of economics were the physiocrats. They have tried to define a different kind of society based on private property and freedom. According the current physiocrat, private property and individual freedom of action were solid basis on which it could build a free society. For physiocrats, laws and natural order were given by God, and the state only had to ensure that law and order were kept.

Unlike the physiocrats, Adam Smith considered the natural order was not given by God, it could be done when individuals do not follow this and each of them act only on behalf of self-interest, established itself over the entropic action of economic agents. What leads Homo oeconomicus towards equilibrium, maximum efficiency and prosperity is “invisible hand” (Popescu, 2004).

A lower presence of the state in the economy, makes entrepreneurship manifest freely in pursuit of goals. Thus, in trade “invisible hand” will guide each individual to the most advantageous trade exchange so, nation's wealth will increase quickly.

Regarding international trade, Adam Smith believes that “*when prefer to support the work of indigenous and not the foreign, he seeks only his own safety, and directing that activity so as to produce the greatest possible value, he is led by an invisible hand to promote an goal which is not part of his intention. Pursuing his interest, he frequently promotes the interests of society more effectively than when trying to promote*” (Adam Smith, 1962, apud Popescu 2004).

In conclusion, we can say that the *'laissez-faire*” principle have a prominently role in the debate on individual freedom and social harmony.

As a limit of traditional thinking we can mention that, within it, has not been analyzed the possibility of imbalances that might occur in economic reality. Economic society is analyzed in terms of an ideal state of stable equilibrium, that if, there is economic freedom, balance is achieved and work by itself. But the classical economists were unable to intuit that between their model of thought, perfectly justified then and the today reality, with all its economic, social, ethical, moral components there are big differences.

However, liberal doctrine (especially the writings of Adam Smith) stayed for a long time in the growth of American capitalist society and not only, where individual freedom has become the dominant principle.

3 The Keynesian Model

In opposition to the policy “laissez-faire” and “invisible hand” is Keynesian doctrine which holds that the free market imperfections can be corrected by government intervention, which also founds at the basis of economic equilibrium.

Result of the Great Depression, Keynesianism promotes a different conception of economic policy regarding new developments in society and also solutions to achieve full employment and economic recovery. In fact, full employment of labor is the peak of Keynesian doctrine, a modern concept of stable equilibrium being possible through government intervention, presented in his book “*The General Theory of Employment, Interest and Money*” (1936). The purpose of “*The General Theory*” Keynes says, is to find what causes a full employment of labor and can thus provide an explanation of unemployment that dominated society in early twentieth century.

In the new economic context, a different ideology is born, namely interventionism, whose onset is associated by economists with the Great Depression of 1929-1933. Considering that the origin of the 1929-1933 crisis was the overproduction phenomenon, supporters of interventionism have shown that market, left too free, could not be self-regulated through its own mechanisms, but rather it caused the imbalance and unemployment and for that they called State for an active role in economy, the only which could limit the negative effects of cyclical evolution of society.

The doctrine of John Maynard Keynes, the main representative of interventionism has been successfully adopted by many countries after the events of the years 1929-1930, manifesting a state control over resource allocation process.

According to some voices weighing in today's economic landscape, as Stiglitz, government intervention (not fine adjustment that recommended Keynes) is justified and necessary because the competition can only exist by state guarantee. State involvement in the economy is needed to reconcile the objectives of public and market objectives.

In the period after the Second World War until the late '70s, interventionism has undergone various stages of government intervention to correct market errors and limit the negative effects of economic imbalances, to that type of intervention that involving concerns in social protection. Also at this time, unfortunately, appeared an extreme form of interventionism, a totalitarian. This form of interventionism has been known to Eastern Europe, where it directed all state activity under conditions of total suppression of private property and individual freedom. Under this type of ideology, called Marxist ideology, all economic and financial resources were available to State and their allocation was possible only through a public decision.

We can say that state interventionism, through its various forms was born and developed an ideology to correct market imperfections and new developments in the political, economic or social.

4 The Neoliberal Models

The structural changes in economic environment since the Great Depression, made the Keynesian thesis to be effective for nearly 30 years, after recording some disappointments, mainly related to the effects of inflationary, of deficits out of control.

Again we return to the market and its laws, its decisive role, while the state has the role of supervisor of macroeconomic climate pursuing set the rules.

Massive investments have led to rapid productivity growth, thus ensuring continued growth in wages and consumption. Stimulation of aggregate demand, the low interest rates are incentive for new investments. To control of inflation and reduce the amplitude and duration of recessions were used various short-term stabilization policies.

For an accurate analysis of the two concepts of economic thought we must refer also to the two major economic crises that have accompanied economic development in the last century. Some economists believe that the invisible hand, the market through its self-regulation force will ensure economic balance. But they do not exclude the state role in terms of anti-crisis policies, but also the invisible hand will have the final role on the behavior of individuals. Thus emerges, the neoliberal current based on classical liberalism and aims at minimizing the state role in economy. So, unlike the laissez-faire, government intervention is considered necessary to guarantee the functioning of markets.

Promoters of this trend are considered first Austrian School economists: Friedrich Hayek and Ludwig von Misses or those of the German School and the other hand we can bring in discussion an American neo-liberalism associated with Monetarism School from Chicago by its chief representative, economist Milton Friedman.

In Romania, Mihail Manoilescu and Vintila Bratianu were among theorists of neoliberalism whose basic principles were: modernizing society, industry development, attracting foreign capital within policy “by ourselves” and, politically, a parliamentary regime based on universal suffrage. Liberalism of Austrian School, mainly promoted by Hayek and Mises that unlike the classical liberalism that no longer use the abstraction perfectly rational Homo Oeconomicus portrayed as the Adam Smith. The character who dominates the socio-economic environment is not that human caricature, but a social individual who is not driven by selfishness, but of other human-specific qualities. They believe, like Adam Smith, that when individuals pursue their interests, they create a spontaneous order. It would be preferable, Hayek believes, that the presence of the state in the individual life to be minimal, but as the experience demonstrated, a civilized socio-economic environment can only exist within a state which must assume this ingrate task and do this without being contrary to one's wishes.

Hayek is convinced that there is not economic liberalism outside the political, and because the man is a synthesis of culture, liberalism cannot exist beyond morality, culture, philosophy, ethics. In this social order, individuals must keep the rules relating to the normative economic and not to the way how they understand the world.

As Hayek and Mises, Milton Friedman sees a natural order possible by minimizing role of state in the economy and encourages the free market.

Milton Friedman, one of the exponents of the Chicago School, brings into attention in the classical liberal doctrine, showing that countries were applied liberal principles, they have worked as a propulsion engine guaranteeing a stable and functional economy. In his book “Free to Choose”, he believes that there should be a clear separation of state powers, even if the market can not exist outside the state. Faithful to liberalism, he exemplifies (analyzing the situation of the former USSR) that the free market is only able to ensure optimal allocation of resources and state excess are most harmful to the economy and society. Friedman believes that when the idea of equality prevails over the freedom, the individual ends up without having any of them.

Like Mises, Milton Friedman addresses the issue of consumer sovereignty. For Friedman, consumer sovereignty, meaning the freedom of choice is a basic principle of market economy. He believes that free competition gives the consumer the best protection and true sovereignty. For such a society is necessary to have private property, non-intervention in the economy, monetary stability and not least the appropriate laws.

Even if “*somehow or other, we are all Keynesians*”, this statement belonging to Friedman, the message of the ultra-liberal economist promotes the ability of free market to deliver a positive growth rate by polarization of capital for those who want to develop, so the state, through fiscal policy, often suffocating, it could not provide it.

5 Conclusions

The phenomenon of crisis is inextricably linked to economic activity, what means that, except effects, often hard in the economic, social or political life, it acts as a “surgeon” of development, revaluating relations or production methods at territorial or global level.

A History of economic crisis, the last two centuries, has revealed a somewhat heterogeneous causes that contributed to them and therefore an equally wide variety of ways to overcome them.

Like the Great Depression of the years 1929-1933, current economic and financial crisis broke out in the context of monetary loans which have reached dizzying rates coming to light those animal spirits Keynes talked about. Thus, from the experience of two major economic shocks, it appears that social memory of crisis is short and that human nature is largely responsible for the repeatability of these phenomena. Onset of any crisis is the effect of interaction of the two largest players in the economy: one that who offers and that who stimulating demand.

Despite some criticism of Keynesian theory, government intervention in regulating economic mechanisms is considered to be more necessary it is already present in the traditional liberal economies like the United States.

Mechanisms, sometimes difficult of the decision makers, particularly at the political level, in some countries may delay limiting the negative effects of the crisis and taking measures to overcome them, which, in terms of globalization, and sometimes can increase the duration of event macroeconomic imbalances.

Approaching the crisis in terms of classical models, induces a dose of risk that few countries are willing to uphold. Thus, the “laissez faire” economic self proved often limits due to, in particular, market actors inventiveness, discovery of the various financial engineers that have disrupted, finally, the natural course of the economy. Also, should not miss the political aspect, which may play an important role in the adoption of a set of effective measures for a sustainable economy.

Lack of social responsibility, ethics and morality is one of the factors underlying market failure, erosion of ethics in business being among the major causes of economic crisis. The feeling of distrust in economic and financial environment and in politics, it is inextricably linked to keeping or not keeping ethical principles for helping the smooth functioning of markets and companies (Dăianu, 2009).

If once the Great Depression, world of science met Keynes which was said to have been an economist who saved capitalism from itself, today we wonder what might happen in doctrinal level, after the crisis. In current times, with Keynes we bring into question both Adam Smith who founded the market economy, highlighting its virtues in increasing the wealth of nations and Marx who said that capitalism can destroy itself, he supporting replacement of it with the planned economy.

If current economic system, capitalism will destroy itself or it will be saved again, depends on the relation of two administrators to his: free market and state. Today, more than ever, the relation between administrators of capitalism is quite tense. After the Great Depression, considered by Hyman P. Minsky a failure of the capitalist system which could be resolved due to only a "Great State", the Winner was named State against Free Market and world economy recorded a macroeconomic balance period until the early 70 known as the Great Inflation. After 70 years, free markets regained their freedom again, being the basis of the economic progress as thought Adam Smith, Ludwig von Mises, Friedrich von Hayek, Joseph Schumpeter, Milton Friedman, etc.

Today like yesterday, we again appeal to the State to correct mistakes of free market, identified as the main culprit of the current crisis.

The current economic crisis has brought increasingly into question redefining the role of state in economy and self-regulating capacity of the free markets. The solution is not giving up entirely on liberal principles, unconditional acceptance of state intervention in the economy or just blaming capitalism, but also acceptance of "*creative destruction*" that Schumpeter considers "the core of capitalism" (Schumpeter, 2011).

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