

History is Back. Are we able to see that?

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Abstract

The world is in changing and the process is full of problems that actually people do not understand because, in fact, they do know few things about history. All these changes have effect in areas like institutional socioeconomic and business.

To improve the actual society, firstly, is significant to realize that the history is back. More than that, the improvement of institutional socioeconomic and the business field ask about some history lessons. It is important to pass this lessons and have better results from them. In a world of rapid changes, it is a must to be competitive and, furthermore, it is important for one to become a changing factor with positive mode at other people. History is back and the influence of past is inevitable. It is important to know that the ancient facts will be come back in a different mode/kind.

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INTRODUCTION

The world is changing and the process is full of problems that people do not actually understand because, in fact, they know few things about history. All these changes have their effects in areas like institutional socioeconomic and business. These fields must change continuously in order to stay competitive. The business field must always be in accordance with the client's demand. The demand is the main element of the economic activities which later determines the offer.

The economic and social environment are changing because the world itself is changing. In fact, if you understand history, it will make your understanding of the variability of all these fields easier. History is back and the influence of the past is inevitable. The main aim of this paper work is to make some remarks regarding the history's influence in the present. It is important to know that the ancient facts will always come back in a different way. Everyone must comprehend the past because there is a real connection with the present and the future, too.

There are a lot of past events which mark the present context. Nowadays relationships between countries have, in fact, a strong connection with the past events. Past tensions and conflicts have their influence in political attitude regarding others states. *Why, for example, the United States of America have always had hidden tensions with Russia?* Because, during the entire Cold War, tensions between these

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states were present. Of course, we can't deny other causes of these silent tensions, but I think that this is the main one. *Why does the United Kingdom refuse to accept others opinions regarding their politics?* Because, in the past, this country was a great power and it is very difficult to ignore this aspect. *Why are there a lot of Arabian people in France?* Because, in history, some of these countries were French colonies. *Why does Romania offer preferential treatment for the Republic of Moldova?* Because, in the past, Republic of Moldova was a component of Romanian's territory. These retrospections explain some of the agreements between the two countries, some interventions regarding political situations and a lot of conflicts. Therefore, past events and situations can be the answers for present questions.

WHEN AND HOW IS HISTORY BACK?

The ability to see past events back in the present could be considered uncommon. One of the most important past events, which is repeating nowadays is the economic crisis. For example, *did people understand that the Great Depression will be back?* No. *Why?* Because we are not able to use past events to understand present situations. Let us see some similar details about the **Great Depression** and **actual economic crisis**.

A. GREAT DEPRESSION

The trigger point for both crisis was in the United States of America. In the '30s, the crisis began on the financial market and the downturn/fall of the New York Stock Exchange. Almost 80 years later, the last crisis started in the same place because of the real estate sector. The existence of the connection between the real estate sector and the bank system has generated a domino effect. When the real estate came down, the bank system fell too and the consequences for all the world were disastrous.

After the World War I, the world was completely changed. The strongest economic depression started on the Black Thursday, the 24th October 1929, when the exchange market downturned. That day, the traders sold their titles on the Exchange Market for prices a few times smaller than their real value. The speculative bubble was breaking; after that, economic and social life were completely changed. Unemployment rate increased from 3% to a critical point of 25%. *What caused it?* The measures taken by the Federal Reserve System and the effects on the people were very strong. The Great Depression had as a starting point the investment effect on the exchange stock market and on the real estate. In order to obtain a consistent gain, the investors assumed bigger risks. The abuse of the consumer credit sent to the market a lot of speculators and for this reason the market mechanism was perturbed. The market can not manage this situation and, because of this, the economic crisis started. On this period, the interventionism of the state seems to be the best solution to overcome the crisis.

The government of the United States of America was focused on offering money for credits; for this reason, the state authority controlled the prices, the credits and offered subventions for some economics activities. Benjamin Strong's policy did not deliver the desired results. A big part of the credits had as a destination the Wall Street and the speculators used it to obtain huge profits. Dow Jones's index doubled in

just two years. The system took a pyramidal form and generated a pyramidal chain. For example, if one American had 1.000\$, he could obtain a credit of 10.000\$ to invest it in the exchange stock market. If he invested 1.000\$ and the price/title grew from 10\$ to 12\$, the profit would be of 200\$. If he had 10.000\$, he would gain 2.000\$ and must have paid a small interest rate to the bank. In this case, he could make the same operation and obtain a credit of 20.000\$. This circle of profitability became attractive for other people and the bank had to offer other credits. For these credits, the banks needed money and the money would be introduced in the economy by the government. The more the pyramidal system of speculations seems to amplify, the bigger the risks are of braking the bubble, which will generate a stronger economic shock. The Federal Reserve System hesitated to increase the interest rate, being afraid of Americans panic.

The price of the title is not always growing and this fact must be analyzed: if someone buys titles of 10.000\$ and the price/title is 10\$ and they cover 1000\$ from private resources, but the price decreases at 9\$/title, the person must buy the titles. Because of this behavior, the client must be afraid of losing money and, in addition, to have demands for his offer.¹ This rationality is, in fact, a vicious circle. The banks can not always offer money for all the people of this pyramidal chain. When the people who hold titles observed the paralysis of the prices, they would suddenly start selling their actions; the prices would downturn and the pyramidal system would fail. During this time, the investors would panic and would sell the titles with prices 10 times lower than the old values, but the demand didn't exist. Many banks involved in this speculative bubble became insolvent and just a part of the system survived these difficult years. Between 1930 and 1932, these couldn't cover costs and credits. The majority of the creditors asked about returning the money and, in consequence, the banks asked the debtors to immediately return the credits.

In August 1929, the Federal Reserve System decided to increase the interest rate at 6%. The exchange markets became more and more agitated and this fact predicted the later downturn of the world's economy. During the following weeks, the less exposed investors to major risks sold their titles. For the first time in that period, the demand was smaller than the offer. A major break was on 24th October when more and more banks offered support for industries regarding the late delay of the payment. On 28th of October, Dow Jones's index fell and the next day, not even banks interventions could save the situation of the world.

Another shock affected the economic system of the United States of America. In the spring of 1931, the European economies downturned. Germany and Austria were devastated after the Versailles Treaty clauses. In Europe, the measures for avoiding the crises generated a growth of the unemployment rate and political instability. The British economy was in collapse and the decision of Norman to evaluate lira according to the gold etalon (April 1925) and the growth of the interest rate generated a real disaster. The consequence was difficult to handle. The governor explained the

¹ J.F. Beaulieu, *La Crise de 1929 et Ses Causes*, available on <http://www.causes-crise-economique.com/1929-2008.htm>, accessed on 25.11.2015

existence of 1.2 million of unemployed people by the incapacity of industrial sector to use the labor. In his opinion, the mistakes of financial sector didn't exist. The overrated lira meant expensive exports for partners and, in fact, a real reduction of its value. Regarding competitiveness, the oldest techniques and instruments of the British economy could not be compared with the American economy. Most of the European countries only had a solution: to immediately send gold reserves to the United States of America.

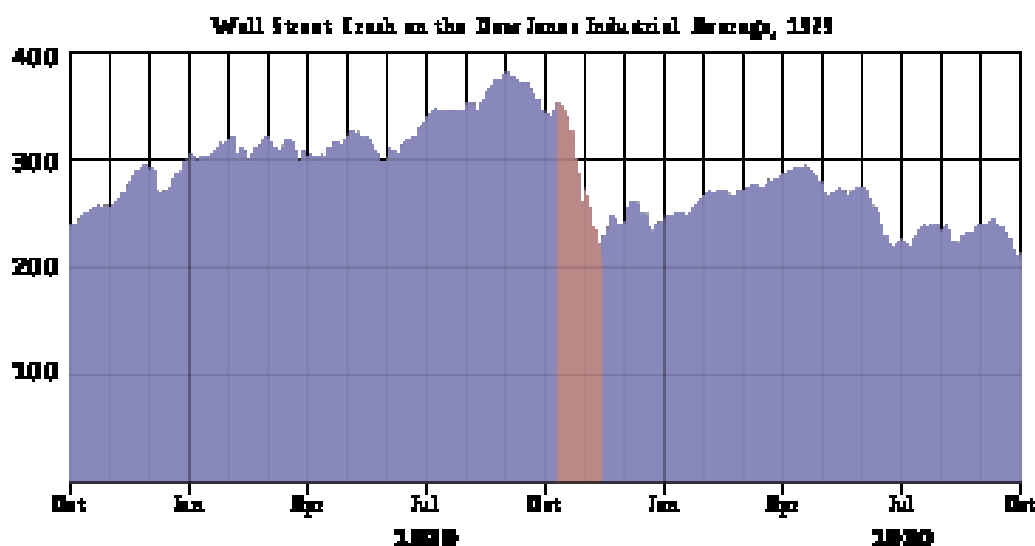


Fig.1: Dow Jones Industrial Average Index in 1929

Source: https://en.wikipedia.org/wiki/Wall_Street_Crash_of_1929

In 1932, 25% of the United States population was unemployed. Most of the people believed that Roosevelt and the New Deal, with Keynesian deficit, would stop the crisis, but the reality seemed to be different: the credits for the infrastructure created new working places. In countries like Germany, Sweden, Japan and United Kingdom, the unemployment rate decreased. By the end of 1937, the American economy was again in recession and the unemployment rate reached a point of 19%. The United States of America overcame the crisis in 1940.

The Great Depression was the most difficult period of the world's economy. The effects on social life and economic environment marked a black period in the world's history, a period that must be avoided in the future. The problem is if the people can understand what happened and how they could react next time. For answering these questions, it is important to take a look at the present crisis.

B. ACTUAL CRISIS

The actual economic crisis generates different degrees of damage in the world's economies. That depends on the vulnerability of each economy and its ability to eliminate toxic activities. The fundamentals of the society have influence on the way of answering the crisis effects. Furthermore, the instruments, institutions and resources offer the option to act in a good way. The origins of the crisis are macroeconomic and

microeconomic. The quantity of liquidity can generate, sometimes, a real economic depression, like nowadays.²

Which are the generating factors of subprime credits? One of these is the macroeconomic situation. The sensibility of the world's economy was covered by the success of free trade on the financial market on global level, the economic integration and the successful action of the central banks regarding inflation. These facts can be pointed as "*silence paradox*". During the actual crisis, the silence paradox was doubled by a "*paradox of credibility*" because the fight against inflation has strengthened the credibility of the central banks. In addition, the excess of liquidity on global level generated a growth of facile credits. The liquidity started with a quickly process of the facilitation credits. This kind of processes can lead to inflation risks.

A relaxation of the condition for obtaining mortgages and buying a new home encouraged the fusions between banks; for this reason, it became the situation when all the people believed that a bank is *too big to fail*. This law was adopted by the Roosevelt's administration after passing the Great Depression. The statistics tell us that more than 9 millions Americans became house owners in almost 10 years. One of these reasons was the exponential growth of mortgages called *prime* and mortgages in risk conditions, called *subprime*. The stability of the inflation is correlated with a small fluctuation of the GDP. This phenomenon, the *great moderation*, is accompanied by a good macroeconomic situation and a modernization of the financial structure for developing countries. The main goal is to increase the credibility. By reducing the costs of the risk premium it will generate a reduction of risk aversions. In August 2007, the level of the risk aversion passed the level of September 2001. Another determinant of *subprime credits* is the interest rate decrease for long term credits; the main effect of this was a global decrease of the credits offered by the state.

In a non-inflation context, the low level of the interest rates generates an expansion of credits number on the market. A large quantity of liquidity was not found in the price of goods and services. For this reason, the efficient use of production agents/factors is not checked and the non-inflationist growth is continuous, though the prices of raw materials are growing.

The excess of liquidity has no impact on the price of goods and services, but it does have consequences on the assets prices. The increase of the assets favors the mortgages because of the fact that the guarantee can be covered by the value of the real assets. More than that, the growth of the value for real assets puts pressure on the monetary policies; in fact, the high interest rates restricts the access to obtaining a house. Generally, the macroeconomic dysfunctions look like a bigger advantage and a relaxation of the conditions for obtaining credits. In this context, the banks adopt strategies regarding the growth of their work's capacity and for easier credit conditions. The financial markets are risky even if the credits market seems to improve the efficiency of the financial system, but in real life, the risk becomes bigger and bigger. For subprime credits, there is the same problem: the massive

² Isărescu M., Nouă lecții din actuala criză financiară, p. 6, available on www.bnro.ro/files/d/Noutati/.../R20090414Guv.pdf, accesed on 03.04.2017

securitization of subprime, compounded with the complexity of some products which generated the amplification of the problems regarding the information's asymmetry.

We can affirm that the present economic crisis started with *subprime credits*, a name that hides the mortgages guaranteed with the value of the goods bought by America's citizens. These credits were offered to the population starting with 2000. When the value of the real estate goods decreases, the debtors start to be unable to pay the credits and the money loss is huge. The events that are present on the financial market generate a *domino effect* with the blocking system and the stopping investments. These facts offer the signals of the hidden malfunctioning market. The prices for real estate registered low values, the interest rates were lower and the period for credit reached 50 years. The breaking of the speculative bubble in the real estate sector does not cover the value of the goods and the return of credits is impossible because their value is lower than the credits.

The nowadays crisis is, firstly, the exhibition /manifestation of a syncope that accompanies, almost all the time, a change regarding the political and economic role on international level. The banks wanted a growth of the advantages regarding liquidities and, for this reason, they offered mortgages guided by the principle *no income, no jobs, no asset*. When these understood that the refund risks had become bigger and bigger, it was too late. The subprime credits were too risky and too many.

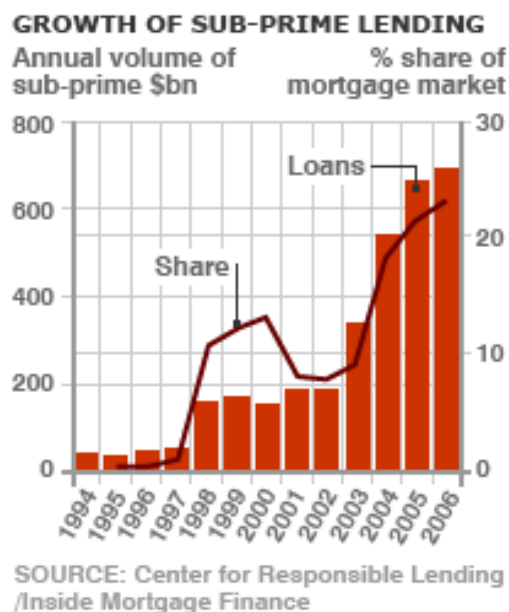


Fig. 2: Growth of sub-prime

Source: <http://news.bbc.co.uk/2/hi/business/7073131.stm>

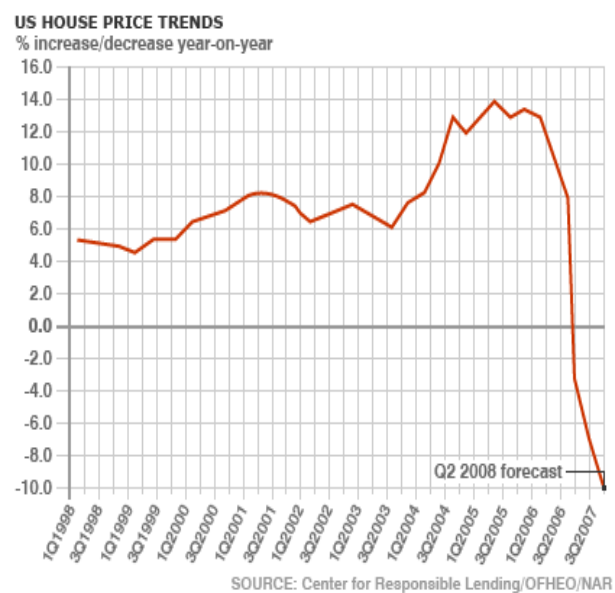


Fig. 3: US house price trends

In September 2008, after the downturn of the real estate sector, an important part of the economists talked about a soft/easy crisis, but, a month later, the GDP of United States decreased by 4-5%. Ben Bernanke, the governor of the Federal Reserve System, promised to introduce money in the American economy and he fixed the interest rate at 0%. The creating money process worked really good and the American banks received more than 250 millions USD dollars in order to avoid the insolvency. *What did the banks do?* After the creation of prerequisites of the subprime, they

declared huge profits for the stockholders and offered credits to the insolvent. A part of the banks invested in others banks or created new ones. For example, the Bank of American Corp received from the government 15 millions USD and, with this money, it doubled the assets in a Chinese bank. After applying this strategy, the American government passed to others alternatives: the recapitalization of the banks and the offering of state guarantees for the risky receivables.

The most affected economies were those in which the speculative fever was overgrown. Eventually, when the speculative bubbles broke, all the happiness disappeared.

WHICH ARE THE COMMON POINTS FOR BOTH OF THE CRISIS?

History is back and the question is if we are able to see this fact. We can answer this question only after we see the similarities. The most part of financial transactions are, in fact, *zero-sum games*, where the earnings for some people are losses for others. As I said in the first part of this paper, we can see some similarities between the crisis of the 1929 – 1930's and the actual crisis.

One of the common points could be the preference for consumption. The individuals use their money just for buying consumption goods and services. The saving money process is, in both of the historical periods, so little significant. The irresponsibility can be one of the main motors of the beginning of the crisis.

In addition, another common point is related to the credits. The access of the credits for goods and services or for the real estate sector generated, for both of the crisis, a growth of the liquidities. Most of them are not covered by the capacity of the people of returning the money and, in the end, they finish by the problems of the banks and individuals. The money that is the source of the banking system had as destination the consumption, not the investment. The population could not return the credits and this fact directed to the banks insolvency.

The third common aspect is about speculation, a bigger speculation. The speculation activity is normal on a liberal market, but the excess of speculation can generate speculative bubbles. For this reason, in the old and the new crisis, the financial market has no power to avoid the fever for easy money. In both of the situations, the speculation process produces, after a good period, the breaking of the bubble and an economic disaster.

The last but not the least, it is important to talk about the government's intervention. The liberal vision speaks about the market adjustment. In fact, the state acts for the economical straightening. The results were, according to the history, not so good for the world's economy. The liberal market can sustain the economy and, in periods of crisis, it can adjust the prices generated by the offer and the demand. The interventions of governmental institutions only generate instability and dependence for the future events.

CONCLUSION: WHICH ARE THE RESULTS OF THE LACK OF UNDERSTANDING OF THE HISTORY?

The speculative bubbles will always exist; these are associated with an abundance of money in the economies. More exactly, we can talk about the savings and the credits. Most of the money is used for buying consumption goods and the other part is used for financial operations with the goal of obtaining profit. The massive flow of funds from one sector (the exchange market, the real estate sector) can generate a growth in this sector. Sooner or later, the investments in this sector will create a pyramidal system and the history will be back. Cupidity can generate the speculative fever and most of the people will be involved in this process before the breaking moment. The speculative bubbles and their cracking represent a disaster for the economies because this means that the distribution of capital is inefficient. In this context, the wealth of the nations will be negatively affected.

The stock market crash represents a dramatic decrease of the prices for a certain period of time whose effect on the economic process and market's work can be lethal. Any crash is accompanied by a speculative bubble. These are, both of them, the symptoms of the economic collapse. The main problem in a speculative bubble is, of course, the human factor and its abusive behavior. The speculation process is interesting and can be motivating for investing and gaining money when rationally practiced. The period between two crisis became shorter and shorter because of the importance of the financial sector and of the economic domain, in general. In fact, the individuals are responsible for the market's volatility because they create most of the market's risks by increasing assets prices over their real value. When the fluctuation is important/ huge, there is a sign for a future speculative bubble. The desire to obtain more and more profit, in a rapid way, is the main reason to committing mistakes and, in the end, to losing the money and the wealth. When we are talking about the speculation process, we are talking about a risk. These elements are connected; for action, only the market and its signals can offer the opportunity to obtain profits.

The lack of understanding the history is a real problem nowadays. This incapacity produces, the same mistakes, every time. The past mistakes can be avoided if the historical phenomenon and context are correctly transposed in the present. Although, it is always about the economic cycle: after good periods there come bad moments. The book's pages are, most of the time, the same, but it is important to recognize it. If a measure did not work once, it will never work. The crisis signs are always the same: the increase of the incomes, a lot of investors, a lot of money, the easily obtained money. In fact, these are just mechanisms for encouraging people in the consumption process. The inflation and the interventions of state institutions decrease the real value of money. It seems to be just the mirage of a good life. *History is a prophet who looks back: because of what was, and against what was, it announces what will be*³.

³ Galeano Eduardo, *Open Veins of Latin America*, available on http://homepage.smc.edu/delpiccolo_guido/Global_10/Open_Veins_of_Latin_America_final_excerpt.pdf, accessed on 07.05.2017

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