INSTITUTIONAL ASPECTS OF THE GLOBAL ECONOMIC RECESSION

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Introduction

The classical economic model, built on the premise of perfectly competitive markets, often downplayed the possibility of financial and economic crises. This perspective assumed that flexible prices and interest rates would naturally lead to efficient production and optimal allocation of resources, ultimately satisfying societal needs. Within this theoretical framework, economic crises were seen as rare occurrences, primarily triggered by external factors, and the market was believed to possess inherent mechanisms to restore growth.

However, the reality of market dynamics deviates significantly from these idealized models. Purely competitive relations are rarely observed in practice. Large economic entities often leverage branding, advertising, and consumer psychology to gain advantages and influence market behavior, thereby shaping the "invisible hand" of the market. This creates additional financial, production, and economic barriers that are absent in a perfectly competitive structure.

The recurring global crises of varying magnitudes (e.g., 1810, 1825, 1935, 2008) highlight a different reality within the economic growth - crisis continuum. These events have prompted economic thinkers to explore alternative solutions, emphasizing the role of state intervention, interdisciplinary analysis, and the interconnectedness of economic and non-economic factors.

It's often overlooked that significant macroeconomic institutional changes have occurred from an ideological perspective. Historically, the capitalist economic system was founded on a liberal ideology, where the state primarily acted as a 'football arbiter,' setting rules without direct intervention. However, since the 1930s, government intervention has become crucial for sustained economic growth and development. Sociologically and institutionally, the economy has progressed to a post-industrial stage, emphasizing improvements in the quality of life.

This analysis aims to further examine the trajectory of societies through economic growth, crisis, and development, considering the corresponding institutional conditions that shape these phenomena.

Methodology

The primary objective of this research is to identify and test universal economic laws and strong institutional linkages, while acknowledging the inherent sensitivity of economic phenomena to dynamic contextual conditions. Consequently, our interpretation of the results carefully considers these contextual factors, recognizing that the applicability or magnitude of observed relationships may differ across various settings or time periods.

Methodology involved a strongcollection and analysis of statistical data pertaining to the global economy, including both developing and developed nations. Macroeconomic time-series data gathered from the World Bank and the International Monetary Fund (IMF) for the period of 1930 to 2020. Key variables included GDP growth, inflation rates, and various economic development indicators.

Methodological approach integrated several scientific principles, including scientific abstraction, inductive and deductive reasoning, synthesis, analysis, and a balanced consideration of both relativistic and absolute perceptions. We utilized a synthesis and analysis approach to reintegrate components, revise their interdependencies, understand systemic properties, and comprehend them in depth. Deductive reasoning was predominantly employed to derive concrete, testable predictions from our abstract theoretical models.

The analytical process involved a systematic application of scientific abstraction to comprehend the complexities and macroeconomic dynamics of the world economy. We deliberately focused on key variables and causal mechanisms directly relevant to our research question, abstracting away from less critical details. This analytical approach was characterized by a dynamic and iterative process of reasoning, where complex economic phenomena were first disaggregated into their fundamental components. This enabled us to identify the origins of economic decline and recession in developed countries, and to generalize the results of economic crises observed in developing countries.

The methodological foundation of this analysis is firmly rooted in scientific inquiry, specifically oriented towards establishing empirically verifiable relationships. This framework maintains a deliberate concordance between deriving generalizable economic principles and comprehensively acknowledging the intricate complexities and contextual heterogeneity inherent in economic systems. Our philosophical stance navigates between the pursuit of absolutism and relativism – the identification of universal, timeless economic principles – and relativism – the recognition that economic phenomena are profoundly shaped by specific historical, institutional, and cultural contexts.

Literature review

In both theory and practice, it is important to distinguish between crises of underproduction and overproduction. Over the centuries, the world economy has gone through recessions of varying severity driven by imbalances between supply and demand: producers were unable to satisfy the basic needs of consumers, which pushed prices upward and triggered economic downturns. Since the 1970s, this pattern has changed to some extent at the institutional level. The quantitative expansion of output and qualitative transformations in production, such as the spread of automation and the increasing use of artificial intelligencehave created new risks, particularly the danger of overproduction crises.

From an evolutionary perspective, alongside the development of economic thought, more concrete proposals emerged for shaping the capitalist system. These debates unfolded in the context of the rise of liberal ideology and the formation of integrated approaches to designing an economic order consistent with that ideology [Smith, 2007]. It became apparent that the English economy had reached a stage of development at which the introduction of liberal economic relations would intensify competition and further enhance productivity. Adam Smith clearly understood this, and advocated in England for "light taxation," liberalization of international economic relations, and the maintenance of regional peace. Under the rule of law, liberal competition, according to his view, enables the "invisible hand" to ensure an efficient allocation and optimal use of resources. This mechanism rests on the idea that the realization of the public interest follows from the pursuit of individual self-interest, and it is reinforced by the division of labour and by institutional arrangements that secure absolute and comparative advantages [A. Smith, 2007].

At this stage in the evolution of economic thought, a classical principle is formulated according to which "supply creates its own demand." This idea is grounded in the view that production, followed by processes of distribution, redistribution, and ultimately consumption, generates the very demand required to absorb the goods produced [Say, 2001]. According to the classical interpretation of this logic, generating demand requires first creating a supply, which in turn becomes a source of income. Framed this way, there appears to be no obvious basis for economic recessions or crises. Yet in reality, such downturns recur with certain regularity. Within the classical model, episodes of underproduction are addressed by stimulating demand, while overproduction is viewed as a manifestation of underproduction in other sectors that prevents the absorption of surplus output. Put differently, if overproduction arises in one sector, the solution is seen as expanding production in other sectors so that the excess supply can be purchased and utilized.

Discussions surrounding human nature are pertinent to understanding the emergence and resolution of economic crises. This is because economic actors often prioritize immediate gratification over long-term prospects, challenging the notion that an "invisible hand" will perpetually ensure economic progress through price signals, guidance, and equilibrium. In this light, John Maynard Keynes's insights into the development of a market-based macroeconomic system – as opposed to a purely capitalist one – become particularly relevant, emphasizing the crucial role of the state's "visible hand" in intervention [Keynes, 1936]. Keynesian economic analysis marked a significant shift by viewing the economic system as an entity incapable of self-regulation, even in the short term. While self-correction might occur in the long run, the interim consequences could be severe. Keynes's work demonstrated that full employment is not an automatic outcome of market forces.

Even if a long-term equilibrium with full employment is theoretically possible, it's largely coincidental. As Keynes famously quipped, "In the long run, we are all dead," implying that waiting for this elusive long-term equilibrium could be detrimental. Therefore, active intervention and control are essential for guiding economic development.

John Kenneth Galbraith argued that economic fluctuations are rooted in the interplay of human nature and institutional dynamics. He particularly emphasized the role of human psychology in fueling speculative bubbles. Galbraith observed that an inherent human desire for quick wealth often drives speculation, leading to a "collective delusion." The success of early investors can convince others of their own superior judgment, triggering a powerful "fear of missing out" (FOMO) that propels prices even higher in a self-perpetuating cycle of market euphoria.

A critical aspect of Galbraith's analysis is society's "notoriously short" financial memory. We frequently disregard the lessons of past speculative frenzies, falsely believing current market conditions are unique or that new financial products are unprecedented. He famously quipped, "The world of finance hails the invention of the wheel over and over again, often in a slightly more unstable version," underscoring this cyclical amnesia. Ultimately, Galbraith's work serves as a cautionary narrative, illustrating how the consistent interaction of human nature, readily available credit, and the allure of new investments repeatedly drives financial markets through cycles of intense booms and inevitable busts [Galbraith, 1990].

Prior to the 20th century, social and economic crises were fundamentally rooted in underproduction. However, in the 21st century, the global economy's downturns and crises are increasingly institutionally conditioned by the consequences of overproduction. Essentially, the prevailing view is that flexible commodity prices, resource costs, and bank loan interest rates are favorable mechanisms for resolving overproduction crises. Concurrently, revolutionary, albeit often unseen, changes are unfolding within developing countries.Hernando de Soto observed that in developing countries, a substantial portion of the population operates outside the formal, regulated economy. This "informal economy" is not only robust and reasonably efficient but also serves as a crucial engine for economic activity, enabling individuals to improve their livelihoods. De Soto noted that when government intervention is minimal, people spontaneously organize into market-based systems to fulfill their needs. This demonstrates a clear preference for private initiative and enterprise over state control, even among those with limited resources. He argues that many developing nations are hampered by lingering mercantilist systems, which are characterized by excessive bureaucracy and a focus on wealth redistribution rather than creation. These systems effectively exclude a large segment of the population from formal economic participation. Therefore, for true economic development, governments must legitimize and integrate these informal economies into the formal system. This necessitates reducing bureaucratic barriers and fostering individual enterprise, rather than suppressing informal activities as problems [De Soto, 1989].

In institutional perspective the governments should create the conditions for a market economy to operate freely and then "get out of the way," empowering individuals to pursue economic opportunities. In essence, institutionalists underscore the economic potential of the poor, contending that formalizing their existing, vibrant informal economic activities is paramount for development, state-controlled solutions. From an institutional standpoint, the democratic evolution of public relations is paramount for problem-solving in both developed and developing economies, and for mitigating challenges confronting the global economy.

Analysis

The recent global financial and economic crisis stemmed from overproduction, manifesting in developing nations as reduced output and economic recession. Unlike previous downturns, this crisis saw a decline in the prices of both real estate (apartments, buildings, structures) and movable property (cars, appliances). This was accompanied by an increase in the prices of essential goods, raw materials, and energy, driven by negative market sentiment and psychological expectations.

Neoclassical theory posits that flexible prices and wages can resolve overproduction crises. The significant price reductions in real estate, machinery, equipment, and other goods and services are thus seen as both a consequence of the crisis and a mechanism for its resolution. A key factor aiding in overcoming the crisis and fostering post-crisis recovery is the growth in production in developing countries. This growth is underpinned by lower wage levels, the adoption of scientific and technical innovations, and the replication of successful economic models. Given that approximately two-thirds of the world's population resides in developing countries, their socio-economic and institutional characteristics allow for a faster resolution of overproduction crises. By leveraging their human, natural, and economic resources, these nations can drive a general downward trend in costs.

In an environment of overproduction, a natural outcome is a decline in prices. For instance, in 2008 - 2009, countries like the USA, Japan, Italy, and Belgium experienced deflation, according to the World Bank[1]. Sustaining these lower price levels and current trends could be achieved by strengthening trade and economic ties between developing and developed nations, thereby increasing trade turnover. Developing economies such as China, India, and Brazil, which successfully deepened these ties, indeed experienced economic growth[2] and development amidst the global financial crisis. Their low resource prices, wages, and rents enable the production of necessary goods at reduced costs, facilitating the absorption of both existing surplus and newly generated output.

The relevance of Keynesian theory becomes apparent here, though it's important to acknowledge that no single theoretical approach can solely address the complexities of economic recovery at the current stage of development. While modern economic thought often anticipates an increase in price levels due to factors like rising labor demand and uneven economic development, the post-

[1] Inflation, consumer prices (annual %) - United Kingdom
https://data.worldbank.org/indicator/FP.CPI.TOTL.ZG?locations=GB

[2] GDP growth, https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG

crisis period can sustain low price levels. This is largely thanks to continuous scientific and technical innovations and their implementation, which allow for the production of essential goods at reduced costs. However, current economic development often overlooks the potential for price level decreases resulting from scientific and technical innovations. Furthermore, the positive impact of volume growth also plays a significant role.

We will now endeavor to apply the Cobb-Douglas production function to analyze these relationships.

$Y = F(K, L) = A\,K^{\alpha}L^{\beta}$(1.)

Y - is the volume of output, which is a function of (K) capital and (L) labor.

A - is a parameter that indicates the productivity of the used technologies.

α, ß - show the productivity of the factors of production.

From this point of view, the production is economically /technologically/ efficient if $(\alpha + \beta) > 1$, and inefficiency can be defined in the case when $(\alpha + \beta) < 1$, economic stability can be defined under the following condition $(\alpha + \beta) = 1$:

In our example, we will consider the case when $A > 1$.In the first stage of the post-crisis development of the world economy, $\beta > \alpha$.

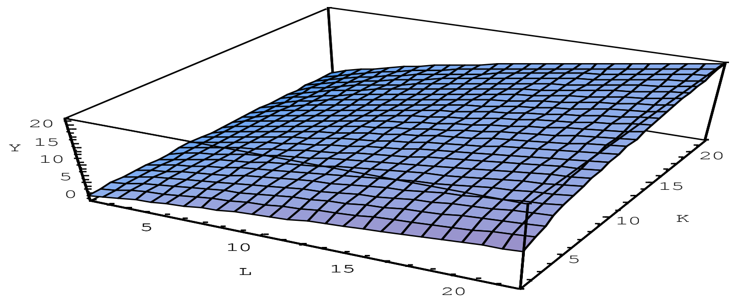

Figure 1. The first period of economic development: the economy is based on labor-intensive industries and production.

In the first stage of the post crisis economic develeopment obviously, labor is used in the economy more and more productively than capital. This heightened productivity, coupled with the inherent logic of economic development, often leads to speculative effects. These manifest as volatile price fluctuations, ultimately culminating in economic crises and subsequent post-crisis situations.

In the second period of post-crisis economic development: $\alpha > ½$, $A>1$, therefore, a positive effect of volume growth is observed: high economic (technological) efficiency is ensured. During the post-crisis recovery and growth phases, maintaining a low price level can be achieved through the strategic introduction and application of scientific and technological innovations.

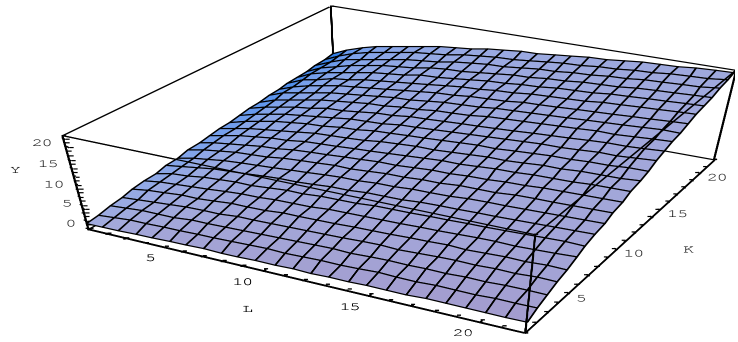

Figure 2. The "second period" of economic development: the economy is based on capital-intensive industries and production structures.

The "second period" of post crisis economic development - the economy is based on capital-intensive industries and production structures. Developed countries can play a significant role in this context, yet the potential contributions of developing nations cannot be overlooked. A compelling illustration of this lies in the remarkable growth of light and heavy industries, the replication of goods and services in fields like mechanical engineering, and the proliferation of substitute products in developing economies. This stage of global economic evolution increasingly necessitates the implementation of robust economic cooperation, integration, and globalization programs between developing and developed countries.

Conclusions and recommendations

The ultimate objective in any economic system is to strengthen, maintain, or increase economic profit. To achieve this, a degree of state intervention, control, and management is essential. This oversight ensures that the efficient resource allocation mechanism, characteristic of the classical economic model, and the formation of market prices align with the principles of a perfectly competitive environment. Such alignment can psychologically mitigate economic uncertainty, thereby stimulating more investment and consumption.

Through well-designed economic policies, the state can not only alleviate pessimistic psychological expectations but also actively cultivate an environment of positive economic outlook. This proactive approach fosters confidence and encourages economic participation, leading to more robust and stable growth.

We are entering a new phase of civilization, driven by values created through knowledge. The traditional theory of pricing, based on costs and labor, is being superseded by a theory centered on the "creation of value through knowledge." Consequently, information and knowledge are now replacing capital and energy as the primary means of wealth creation, much as land and labor were supplanted two centuries ago. The model of a perfectly competitive market, rather than assuming a constant quantity, focused on identifying the conditions necessary to establish its desired "ideal" state within the economy.

Post Scriptum: The institutional basis of the "economic miracle" of China and India:
In the contemporary economic landscape, marked by recurring crises, significant attention is directed toward understanding factors that enhance economic management and control. This analysis will focus on the economic experiences of developing Asian countries, particularly their extensive replication of global brands and production of numerous world-renowned products. Asian nations collectively comprise nearly 50% of the global population, with India and China alone accounting for over 2.5 billion people (exceeding 33% of the world's total). This demographic reality positions them as both vast consumer markets and significant production hubs. Their large, lower-wage labor forces, among other advantages, enable the output of competitive, high-quality goods at reduced prices. However, recent shifts in China's economic policy are notable. There's a discernible effort to "capture and monopolize markets" through the strategic production of diverse product groups. These multi-type, multi-class offerings cater to various socioeconomic strata, providing close and equivalent substitutes for consumers across different income levels. Over time, Chinese entrepreneurs involved in this process have specialized, enabling them to introduce products under new brands and trademarks. A long-standing competetive dynamic exists between India and China. While China has maintained an average economic growth rate of 8-9 percent, India's has hovered around 5-6 percent, suggesting a more favorable economic future for Chinese residents. Over the past decade, China's economic development strategy, characterized by cheap labor and massive production, has garnered considerable international attention, propelling it to become the world's leading exporter. For instance, approximately 39 percent of the U.S. trade deficit in recent years has been attributed to trade with China. The "Made in China" label is ubiquitous, appearing on one in three products in the U.S. market and one in eight globally, effectively placing America, a major consumer market, in a unique state of dependence on Chinese goods. China's distinct currency policy – maintaining a relatively low currency value, attracting substantial U.S. currency, and sustaining high export volumes – aims to expand its global consumer markets. The recent global economic crisis underscored the importance of diversifying risk and avoiding over-reliance on a single consumer market. Consequently, China is actively decentralizing consumer markets and fostering a "consumption-based economy by capturing international markets."

The success of China's reforms has been significantly influenced by the development of a supportive foundation rooted in non-economic factors, including socio-political and moral-psychological elements. Initially, reforms targeted industries with quick returns on investment and high profitability. From a moral-psychological perspective, cultivating a cohesive work team where each member understood their role and the significance of their contributions was deemed crucial. The "evolutionary principle," promoting gradual development in relevant sectors and regions, was key to implementing these reforms.

The economic crisis of 2007 marked a shift in the relationship between developed and developing countries. Notably, some developing nations demonstrated greater resilience to negative economic impacts, from an economic security standpoint, than many developed countries.

India's economic development is significantly driven by its vast labor force, specialization opportunities, and a national economic policy prioritizing high-technology integration. Despite India's considerable institutional and economic achievements, these have often been overshadowed by China's rapid progress on the Asian continent and globally. However, many international experts project India to become the world's third-largest economy by absolute GDP value around 2050. The comparatively low wage levels in India – an eight-fold difference compared to developed countries – enable the simultaneous engagement of multiple specialists on projects and in programming. This collaborative approach significantly boosts labor productivity, whereas organizing such collective effort in the United States would be far more complex and expensive.

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The success of economic reforms is attributed to a foundation of non-economic factors, including socio-political and moral-psychological elements, alongside the gradual "evolutionary principle" targeting profitable industries. The 2007 economic crisis highlighted the resilience of some developing countries compared to developed ones. The economic growth of many developing countries is propelled by its large workforce, specialization, and high-tech policies. For example in India, despite being overshadowed by China, experts predict India will be the third-largest economy by 2050. Its low wage levels facilitate a collaborative approach to projects, enhancing productivity at a lower cost than in developed countries like the United States.