Globalization, crisis and financial instability: the role of confidence

Michele Petrocelli, Università degli Studi Guglielmo Marconi, Rome, Italy

ABSTRACT. Globalization makes financial and economic markets more integrated but vulnerable to speculative attack and worldwide crisis. This paper aims to introduce in the economic debate also social phenomena, as a relevant cause in financial system instability. Speculative bubbles and self-fulfilling prophecy phenomena often cause financial and currency crisis. From them the effect arrives to real economy making stronger the effects of financial crisis. Confidence plays a key role to explain speculative bubbles and the business cycle, too. In this study the level of confidence (of households, firms and banks) is introduced inside the traditional IS-LM model, to explicate how it can determinate also the ineffectiveness of economic and monetary policies. Confidence cycle can also explain Keynesian multiplier values less than one, sometimes reported by some economists. Nevertheless, it explains that it does not mean that public expenditure stimulus policies would fail their objectives anyway. Economic policy decisions should be make taking into account the social effects and their “stories” that is why they are political choices, and not technical.

KEYWORDS: Bad faith, Confidence, Corruption, Credit, Financial and currency crisis, Keynesian Multiplier

The need of a social approach

Currently, we are living a time full of changes and transitions especially referring to the economic and financial context. Consequently, we need new points of view and new models to try to understand what is going on. In this short paper we want to propose some open questions, trying to suggest a new global vision of phenomena, based on recent literature.

In particular, in this paper we are going to face some open questions:

1. Why economy experiments business cycles? Is there a
connection with the existence of financial bubbles?

2. About financial bubbles: why operators cannot understand from experience in case of financial crisis?

3. In 2009, because of the use of fiscal multipliers to project the benefits of the American Recovery and Reinvestment Act of 2009, economists were in fact deeply divided about how well, or indeed whether, such stimulus works. So, why sometimes do we experiment Keynesian multiplier values less than one? Moreover, in this case, is still a good idea to use public expenditure stimulus?

To try to explain these issues, we need to introduce a social approach that would take into account topics like confidence, fear, bad faith, corruption, favor markets (clientelism and nepotism), concern for fairness, the stories we tell ourselves about our economic fortunes (See Galbraith, 2004; Petrocelli, 2008 and 2010).

Only analyzing this kind of matters, we can introduce new visions inside the economic debate, in order to extend the field of observation, looking for the causes of assumed dynamics.

**Crisis and globalization**

Economic and financial integration, as a normal consequence of globalization, makes it easier economic growth, but also systemic crisis. Emerging countries experiment high growing rates. Their demand of funds has been a great opportunity of profitable investments (Krugman, 2000). There has been high liquidity and funds availability into Developed Economies; consequently, in those countries there was a political pressure to reduce the effectiveness of financial constraints, making the financial system highly vulnerable.

Indebted countries tended to protect themselves by buying huge reserves of dollars, and often linking their currencies to the dollar or the euro. It made the system even more unstable, exposing the economies to disastrous consequences in the case of asymmetric shocks.

From globalization, crisis become more and more frequent, more and more significant over the world.

We can try to summarize some milestones in this path, representing complex crisis.

In 1983 and 1997 there were two important crisis, both linked to investment flows in emerging economies and in both cases, the crunch enlarged to an entire region (Latin America in 1983, South-East Asia in 1997 public debt crisis). In the middle of these two events, also Developed countries had been involved. In particular, in 1992 there was the speculative attack to weaker currencies within the European Monetary System, causing the temporarily failure of that system.

In the same way, at the beginning of this century, just after the South-East Asia crisis, in the US and other developed countries there was the bust of the so-called dot-com bubble.

The 1983 crisis came from a long period of investments in South America made by banks of developed countries, to finance public debt or, sometimes, private State-guaranteed loans. The dimensions of those flows had been incredible. In the ten years after the oil crisis of 1973, Emerging countries obtained loans for 480 billion dollar. In 1982, the debt of the lone Latin America with Western countries amounted to 300 billion dollars. All the banks (also the local ones) ran to employ their
immense liquidity, mostly due to the increase in the price of oil.

Any risk evaluation over loans were overtaken by the fever of investment, in the false awareness that the financial system would be able to solve any occurred problem. When in 1982, the Mexican Ministry of Finance went to Washington to announce the impossibility for Mexico to give back its 80 billion dollar debt (Gwynne, 1987), it was becoming clear that the world was on the brick of bankruptcy because of the moral-hazard logics under the choices in financing developing countries (Dooley, 1997).

In addition, South-Est Asia crisis of late 1990s has been interpreted by some literature as the ineluctable result of the excess of loans in a fragile economic and financial system (Corsetti, Pesenti, Roubini, 1998).

The financial and currency crisis in Asia was originated by an excess of investment and overproduction, alimented by moral hazard mechanisms. They were also caused by the development of financial markets, and by the employing of liquidity in short and very short-run investments. In other world, crisis was due to speculative decisions, possible thanks to the capital market liberalization (Stiglitz, Greenwald, 2003).

Trade and financial integration, caused by innovations in information and communication technologies, stresses the difference between intrinsic value and market value of assets. Intrinsic value is the value of assets compatible with the potential growth of an economic system.

Market value is determined by expectations of operators, by accelerating the benefits of the developing process (speculating and “anticipating” the expectations of price variation). The distance between them, can make it difficult to reach the potential grow.

The fact that an economic system passes through overheating periods and depressions, is due to the dynamics of confidence and expectations of operators, defined because of the social system and the dominant culture.

Financial (credit) and currency crisis are often interrelated. When currency changes its value in terms of other currencies so quickly, it compromises the possibility that the currency could be used by other countries in international trading or as foreign reserve. If investors lose confidence in an economy and its currency, they begin to disinvest assets in that currency.

If this behavior occurs on a large scale, in a short time, we talk about speculative attacks. If Central bank fails in protecting national currency, there is a rapid, significant and continuous depreciation.

In the currency crisis in South East Asia in 1997, the currency lost, on average, 50% of its value against the dollar. During a currency crisis, there is an inversion in capital flows.

Indebted emerging countries experiment low domestic savings, and ensure high returns on foreign investments. International capital mobility is potentially profitable both for emerging economies and for developed countries.

Usually, before to be hit by a currency crisis, emerging economies experiment a high capital net-inflow (and therefore a current account deficit). After the beginning of the crisis, the net-flow of capital reverses dramatically. In other word, currency crises caused a financial crisis.

---

1 According to Samuel C. Gwynne (at that time employed in the international directorate of Cleveland Trust Company), the fever that pushed banks to underestimate the loan of so relevant resources in developing countries was also caused by the unskilled people employed by the banks, considered more as fund vendors, than risk analysts (Gwynne, 1987). Employing liquidity had been considered as a great, can’t-miss it opportunity of profit. So that it was undertaken also by banks usually risk-adverse, but involved in the job by international bank actions (see Savona and Sutija, 1987), in a huge asymmetric information trap.
Financial integration and the possibility to move quickly funds from one country generate instability, making it easy for a crisis to be generate and spread. Some Countries tried to protect themselves by the so-called dollarization\(^2\), to prevent currency risk by using an amount of reserve to avoid speculative attack. It meant a large purchase of US securities as reserve. This make huge liquidity arrive on financial market, increase the indebt propensity and the entropy of the system, with high risk of financial or currency crisis. The more the financial markets are open and the fund borrowing easy, the more the financial system becomes vulnerable. In this sense, Globalization fails its promise to favor the developing economic growing only by the opening of markets\(^3\).

High liquidity and indebt propensity make ease the rising of bubbles. Often also currency crisis are caused by financial speculative bubbles. The race to purchase the assets of the country makes their value grow, regardless of the actual capability to generate returns in the future. Those who buy the asset at a high price are sure that they will be able to sell it, at a higher value, exploiting the upward expectations, regardless of the economic fundamentals. At the beginning, it works as expected. It strengthens the belief that the asset will continuously increase its value. Many operators will buy it, even borrowing funds to do it. Credit grows up and for a period, the behavior of economic agents self-feed the growth of the bubble. When it will become clear the unsustainability of the investment (the price is too far from the actual value of assets), the illusion vanishes and the value of assets falls as quickly as it had risen, causing defaults. Defaults mean crisis in the real economy, credit crunch, failures, unemployment: in other words, crisis is experimented also in the real economy.

**The role of confidence**

The social system projects in the economy a system of expectations. Confidence is an in-grain belief in the community (rightly or wrongly). It is acquired as fact by all members of the group: even if formulated as hypothetical, the future phenomenon where you have confidence is perceived as virtually certain.

Compared to expectations, confidence is a social fact, an attribute of the future state of nature, universally strongly accepted for sure by anyone. People consider the stories that they learn inside their social contests that give them the context of facts. These stories determinate cause-effect links between variables and facts, regardless of any empirical evidence, driving individual expectation and behavior (Akerlof, Shiller, 2009).

This perception and this conviction lead to some different effects:

---

2 We can talk about full dollarization, if one country officially adopting the currency of another for financial transactions. Most developing countries or transitional economies already have a limited, unofficial form of dollarization just adopting market mechanisms. Such informal dollarization is a response to economic instability and high inflation, to protect assets from the risks of devaluation of their own currencies, where debts are usually expressed in dollars (Berg, Borensztein, 2000).

3 Inside the Globalization, Market openness is not a sufficient condition to ensure the development of countries. Often risk are more than advantages. For example, often, free trade principles clash with domestic norms and practices, and free trade forces governments to give up the welfare state. (Rodrik, 1997).
A self-fulfilling prophecy is a prediction that directly or indirectly causes itself to become true. A positive or negative prophecy, strongly held belief, or delusion – declared as truth when it is actually false – may sufficiently influence people so that their reactions ultimately fulfill the once-false prophecy. As in the Thomas theory: “If men define situations as real, they are real in their consequences” (Thomas and Thomas, 1928).

The concept of self-fulfilling is defined by Merton in the following way:

> The self-fulfilling prophecy is, in the beginning, a false definition of the situation evoking a new behavior which makes the original false conception come true. This specious validity of the self-fulfilling prophecy perpetuates a reign of error. For the prophet will cite the actual course of events as proof that he was right from the very beginning. (Merton, 1948)

An interesting and very famous example described by Merton is the case of the Last National Bank and its Black Wednesday in 1932. Last National Bank was a typical bank, managed honestly and quite properly. As a result, like all banks, it has some liquid assets, but most of its assets are invested. False rumors spread that something is wrong with the bank and a large number of customers rush to the bank to try to get some of their money out while they still can. The number of customers at the bank increases, as does their annoyance and excitement, which in turn fuels the false rumors of the bank’s insolvency and upcoming bankruptcy, causing more customers to come and try to withdraw their money.

At the beginning of the day, the bank was fully in health. However, the rumor of insolvency caused a sudden demand of withdrawal of too many customers, that banks cannot answer, causing the bank to become insolvent and declare bankruptcy.

Obviously, the system works also in the opposite way. If there is the common idea that a company is too big to fail, for its social, political or economic relevance, banks and households will continue to finance its investments, even in case of huge risk and in presence of behaviors not risk adverse. The more savings and banks’ funds are given to this company, the more its bankrupt would mean the collapse of the whole social and economic system: increasing the idea that it is really too big to fail.

The other fact is the speculative bubbles, a condition in which security prices rise quickly above their value and will continue to do so until prices go into freefall and the bubble bursts.

An interesting definition by Robert Shiller:

> A speculative bubble is a social epidemic whose contagion is mediated by price movements. News of price increase enriches the early investors, creating word-of-mouth stories about their successes, which stir envy and interest. The excitement then lures more and more people into the market, which causes prices to increase further, attracting yet more people and fueling ‘new era’ stories, and so on, in successive feedback loops as the bubble grows. (Shiller, 2012)

---

4 The sociologist Robert K. Merton is also credited with coining the expression self-fulfilling prophesy, as the title of his famous article (Merton, 1948)
In the upward phase (boom), people buy stocks and securities at high prices, believing they could sell them at a higher price. The growing of the prices and the opportunity to get a profit push them to borrow money, making the value grow again. It can happen until confidence is lost and a large crash occurs. At the end of a bubble, resources are moved again, causing prices to deflate.

Why people do not learn by these mistakes? Why the (few) warnings against speculation (and its risks) in the boom times are ignored? Why Institutions do nothing to avoid or slowing down the upward phase? It's the consequence of the short-run view typically adopted in developed countries, associated with the free-riding phenomenon. Taken by the fever, anyone thinks they can become rich without effort in few time, in the enthusiastic atmosphere around him in a good period, when anyone can make a fortune buying and selling stock in few time. Also institutions, don’t stop this phenomenon riding the consensus around this “positive moment” when anyone can become rich without effort.

Social feelings fluctuate around the business cycle, along the going of confidence that is the set of shared expectations of people, able to determinate individual behaviors.

In the period of economic growth, there is more confidence and cases of bad faith and corruption usually can rise up (Galbraith, 2004). Anyway, there are more investment, credit, consumption and, usually, debt, inflation. In these periods, confidence grows making the economy grow more than its physiological trend (and the potential).

At a certain point, it becomes impossible for the economy to increase furthermore, and expected growth is higher than the actual potentiality. It can trigger off the crisis. It means worse expectation, less credit and consequently less investment, production, employment and consumption. It is the economic downturn phase, when there is the collapse of confidence that reaches its lowest level. Inside people feeling usually are fear, concern for fairness. Usually there is also a harder fight against
corruption and privileges. In these times the distance between the rich and the poor increases. Usually, in those cases economy restarts for an external stimulus that can make the economy grow up again.

![Diagram](image)

Figure 2. The role of confidence in business cycle

We can try to analyze the value of the Consumer Confidence index to find some empirical evidence about the relation between business cycle and confidence.

5 The OECD Consumer Confidence Index is the result of surveys made in different Countries, oriented to identify the opinion about the economic trend in next eleven months (finance, real economy, employment, saves), using data from the national statistic systems. The index is standardized making possible comparisons between different countries and economic contexts. This index provides also qualitative information useful for monitoring the current economic situation and advance warning of turning points in economic activity. For furthermore information see the OECD website [www.oecd.org](http://www.oecd.org).
Figure 3. Confidence and business cycle in USA (elaboration of OECD data)

Figure 4. Confidence and business cycle in the Euro-Area (Source: elaboration on OECD data)
It is possible to argue that there is a strictly correlation between confidence and business cycle. “Local crisis” make countries have different connections with business cycle. The crisis of 2007-2008, the first properly global crisis, caused a fall of Consumer Confidence, anticipated by a pick of expectations (speculative bubble). Therefore, graphs in Figures 6, 7 and 8 show that we can record a positive correlation between Consumer confidence (in 2009) and growing rate of productivity (in the period 1998-2008)\(^6\), but low-correlation\(^7\) between Confidence and "punctual" productivity (GDP per worked hour) or competitiveness (Global Competitiveness index\(^8\) in the same period) (Petrocelli, 2011).

In other word, it seems that productivity growth in past years can give confidence also during the crisis, because create a strong belief in the capability of the economy to grow up quickly.

---

6 The two variables (even over 10 countries) shows a very high correlation level (Pearson) equals to 93%

7 In both the cases there is a negative, low correlation (measured by the Pearson index): -28% comparing Consumer Confidence and GDP per worked hour and -21% between Confidence distribution and Global Competitiveness Index.

8 Global Competitiveness index is a synthetic index elaborated by the World Economic Forum with Columbia University that attempts to quantify the impact of a number of key factors which contribute to create the conditions for competitiveness, with particular focus on the macroeconomic environment, the quality of the country’s institutions, and the state of the country’s technology and supporting infrastructure. For the period 2009-2010 there were analyzed 134 countries.
Figure 6. Consumer confidence and productivity variations (Source: OECD)

Figure 7. Consumer confidence and GDP per worked hour (Source: OECD)
Real and Financial equilibrium model based on Confidence

Confidence and credit market

Finance is obviously largely conditioned by changes in business and consumer confidence. The cycle of Confidence shifts over time the outcomes of business and real economy; the more it is possible the more there are complex financial instruments.

Banks paly a key role. They operate with “strategic” behaviors, aiming to maximize their profits and minimize the cost of their failure (and the related risk).

Credit has a key role in the economic grow, because it is the most important factor of liquidity. Confidence is the result of the social system. We can introduce this concept in our simplified model of economic (real and financial) equilibrium, as an exogenous variable, although the relation between confidence and output and interest rate is not so simple.

We can try to adopt a model based on LM curve, to represent the balance on the credit market, making expectations of banks and borrowers become explicit.

Credit has a key role in the economic grow, because it is the most important factor of liquidity. Confidence is the result of the social system.

We can introduce this concept in our simplified model of economic (real and financial) equilibrium, as an exogenous variable, although the relation between confidence and output and interest rate is not so simple. In this sense, we can try to adopt a model based on LM curve, to represent the balance on the credit market, making expectations of banks and borrowers become explicit.

Banks provide loans, after an accurate evaluation about:

---

9 For a more detailed analysis of the real and financial effect in confidence changes, see Petrocelli (2011).
• The spread between loan rates (resulting from the loan market) and returns on government bonds (that approximately equals to the cost of deposits); it results from the Securities market.
• The information around borrowers and their business;
• The expectations about the future of the economic system;
• The degree of regulation, decisions of the central bank (e.g. about interventions in the open market or the level of minimum reserves).

Banks, also, employ capital and deposits to provide loans and buy government bonds (assuming exogenous bond supply).
Credit supply function (LS) can be expressed also considering the level of confidence of financial system ($f_f$):

$$LS = ls_2 \left( i_p - i_r \right) + ls_1 Y + q'_2 K + q'_2 K_f + f_f + q_3$$

With:

- $ls_2$: effect of spread on LS
- $i_p$: interest rate on loans
- $i_r$: returns on government bonds
- $ls_1$: incidence of income on LS
- $q'_1$: correction factor linked to the degree of capitalization of the economy
- $K$: level of capitalization of the economy
- $q'_2$: correction factor connected with capitalization of banks
- $K_f$: level of bank capitalization
- $f_f$: correction factor caused by confidence of the financial system
- $q_3$: correction factor connected to market regulation and monetary politics.

To simplify, we can group all the exogenous variable, making evident the endogenous variables, confidence and returns on bonds

$$LS = ls_2 \left( i_p - i_r \right) + ls_1 Y + f_f + q$$

With:

$$q = q'_1 K + q'_2 K_f + q_3$$

On the other side, demand of Liquidity refers to the Keynesian approach: it depends on income and interest rate on loans. We can also introduce confidence of consumers and business and other economic condition (capitalization of firms and household wealth).

$$LD = l_1 Y - l_2 i_p + z + f_L$$

With:

- $l_1$: liquidity demanded for transaction and precautionary motive for any income unit;
- $l_2$: relation between liquidity and credit demand and interest rate (speculative motive);
- $z$: correction factor on behavior of fund borrowers connected with present state of nature of the economy;
$f_c$: correction factor caused by confidence of consumers and firms (borrowers).

In case of economic growth, wealth and investments grow up; consequently, there are better expectations, and demand of loans increases.

In case of recession, confidence falls, and there would be two different effects: negative expectations make private sector to reduce their liabilities and they need to borrow more funds to cover capital losses.

Considering equations (1) and (3), it is possible to set the liquidity market equilibrium, defining the relations between confidence of the financial system and credit market:

$$LS = LD$$  \hspace{1cm} (4)

$$LS = l_s (i_p - i_f) + l_s Y + f_f + q = LD = l_1 Y - l_2 i_p + z + f_L$$  \hspace{1cm} (5)

$$l_s (i_p - i_f) + l_s Y + f_f + q = l_1 Y - l_2 i_p + z + f_L$$  \hspace{1cm} (6)

$$i_p (l_s + l_1) = (l_1 - l_1) Y + f_f + l_s f_f + l_2 i_f + z - q$$  \hspace{1cm} (7)

$$i_p = \frac{i_Y}{l_s + l_1} + \frac{l_2}{l_s + l_1} i_p + \frac{z - q}{l_s + l_1}$$  \hspace{1cm} (8)

There is a positive correlation between product/income and interest rate (on loans). It is possible to consider this relation as another way to describe the equation under the LM sheet (Figure 9).

We can consider shifts of the curve, in occasion of confidence changes. During a recession, or generally, bad times, confidence (of banks, firms and households) falls.

![Figure 9. Relation between income and interest rate on loan considering confidence of the financial system](image-url)
It means less supply of loans from the financial system (credit crunch phenomenon). We can record an uncertain effect on demand (probably less credit demand). On one side, there is a reduction of output and credit, so less liquidity is needed. On the other side, firms ask for more credit to cover the losses in asset values, after the recession.

Figure 10. Effects of confidence changes on LM curve

We cannot say for sure how the LM curve will shift. We can however assume that in case of strong credit crunch it probably shifts to higher level of interest rate for any income level (LM1 in figure 10)

**Confidence and real market**

We can also introduce confidence inside the real market equilibrium (making a revisiting of the traditional IS sheet).

We can consider an economic system, closed from abroad. In this case, as known, we can express the income as the sum of demand and supply for consumption (C), investment (I) and public expenditure (G).

\[ Y = C + I + G \]  

(9)

**Consumption** depends on present income level and expectations about future income: that means household confidence.

\[ C = C_0 + c(Y - T) + c'(Y_c - Y) \]  

(10)

\( C_0 \), as usual, is the exogenous component of consumption and \( c \) is the marginal propensity to consume. \( Y_c \) is the future income expected by consumers. With \( c' \) it is represented the effect on
consumption of a gap between expected income and effective one. $T$ is the tax level (considered as constant, exogenous, and net of transfers).

We can assume that household expectations on future income depend on past income as in equation (11).

$$Y^e_c = \alpha Y$$  \hspace{1cm} (11)

Of course, the variable $\alpha$ will be more than 1 if households have positive expectations on economic growth in the future. Less than one in case of negative forecasts.

By considering (11), (10) becomes:

$$C = C_0 + cY + c'[\alpha - 1]Y - cT$$  \hspace{1cm} (12)

We can define the household confidence as the expectation on future income:

$$f_c = c'[\alpha - 1]$$  \hspace{1cm} (13)

We can explicate the household confidence inside the function of consumption:

$$C = C_0 + cY + f_cY - cT$$  \hspace{1cm} (14)

*Investments* depend on interest rates (on loans) and firm expectations of economic growth (business confidence). As for the consumption function, we can consider a linear relation between those variables as in (15).

$$I = I_0 + b'[Y^e_f - Y] - v_i$$  \hspace{1cm} (15)

$I_0$, as usual, is the exogenous component of investments, $Y^e_f$ is the future income expected by firms. With $b'$ it is explicated the effect on consumption of a gap between expected income and effective one. As usual, $v$ measure the marginal effect on investments of changes in interest rate.

It is possible to assume that firms’ expectations on future production depend on past income level:

$$Y^e_f = \gamma Y$$  \hspace{1cm} (16)

We can rewrite the (15) as follow:

$$I = I_0 + b'[\gamma - 1]Y - v_i$$  \hspace{1cm} (17)

Introducing business confidence:

$$f_g = b'[\gamma - 1]$$  \hspace{1cm} (18)

$$I = I_0 + f_gY - v_i$$  \hspace{1cm} (19)
Introducing the (17) and the (19) inside the (9) and grouping in \( A \) all the exogenous variables (also \( G \)), we obtain:

\[
Y = A + cY + f_c Y + f_b Y - \nu_i p
\]  
(20)

\[
Y = A + cY + (f_c - f_b) Y - \nu_i p
\]  
(21)

\[
f = f_c + f_b
\]  
(22)

\[
Y = A + cY + f Y - \nu_i p
\]  
(23)

\[
Y = \frac{A - \nu_i p}{1 - c - f}
\]  
(24)

With:

\[
A = C_o + I_o + G_o - cT
\]  
(25)

Figure 11. Confidence and real market equilibrium

As in the traditional IS-LM model, also here we obtain a negative correlation between product/income and interest rate.
Effects of changing in confidence

We can now consider changes in confidence and effects on the IS-LM system as redesigned.

\[
\begin{align*}
\text{IS} \rightarrow Y &= \frac{A - vi_p}{1 - c - f} \\
\text{LM} \rightarrow i_p &= \frac{l_1 - ls_1}{l_2 - ls_2} Y + \frac{f_L - f_F}{l_2 - ls_2} + \frac{ls_2 - l}{l_2 - ls_2} - t_y + \frac{z - q}{l_2 - ls_2}
\end{align*}
\]

(26)

In the upward phase of the business cycle, confidence rises up. In expanding phase of economy, the curves shift to LMR and ISR (looking to the Figure 12).

More confidence means higher demand of goods and credit. It is not clear the effect on interest rate; it depends on bank market reactivity in expanding credit. If supply of liquidity equals (or exceeds) demand, interest rates decrease with real effects on investment (as in the traditional model). This means overheating of economy that could lead to speculative bubbles.

In descending phase of economy, curves shift back (to LMR and ISR in Figure 13). Risk increasing inside the business makes banks reduce the supply of credit, redefining their portfolio. Households’ wealth and firms’ assets decrease and there are ominous income expectations. This lead household consumption to fall and firms to reduce their dimensions and investment. Real economy could enter the recession.
Confidence and Keynesian multiplier

Confidence crisis can make economic politic ineffective. It can cause a multiplier value less than 1. We can try to demonstrate it using the previous equations.

We can calculate the Keynesian multiplier level:

\[ m = \frac{\Delta A}{AY} = \frac{1}{1 - c - (f_c + f_v) + vl} = \frac{1}{1 - c - f + vl} \]  

\[ \frac{\partial m}{\partial f} > 0 \]  

(27)  

(28)

There is a positive correlation between multiplier and confidence. When confidence falls, also propensity to consume decreases very quickly. Multiplier can fall under 1, in case of great effect also on investments (crowding out effect). In other words, multiplier falls under 1 when:

\[ f < vl - c \]  

or

\[ -f > c - vl \]  

(29)  

(30)

Some economists empirically recorded values of Keynesian multiplier values less than one in the USA, strongly criticizing the Obama’s exit strategy in 2009, based on the public expenditure stimulus (Barro, Redlick, 2009b).

The question, in case of multiplier less than one, is if it is really useless (or counterproductive) to adopt a public expenditure stimulus policy? To answer this question we have to take into account that during a recession, a no-action policy can cause a further worsening of confidence. In fact, if
people believe that the policy will be successful, it can make them achieve positive actions with successful consequences (it is a positive consequence of the Merton’s self-fulfilling prophecies). Expansive policies can make the confidence and multiplier rise up, becoming effective. In other words, it should be more a social evaluation than a strictly economic decision.

References


Berg Andrew, Borensztein Eduardo (2000), Full Dollarization: The Pros and Cons, “Economic Issues n. 24”, International Monetary Fund


Galbraith Kenneth J. (2004), The Economics of Innocent Fraud: Truth for Our Time, Boston, Houghton Mifflin Harcourt

Gwynne Samuel C. (1987), Selling Money, New York, Weidenfeld and Nicolson


OECD (2009), Financial crises sees collapse in OECD consumer confidence, Paris, OECD

Petrocelli Michele (2008), Il labirinto clientelare: la crisi di sistema dell’economia italiana, Roma, Armando
Petrocelli Michele (2010), Benessere, sviluppo e libertà: l’illusione svelata dalle crisi finanziarie ed ideali del capitalismo moderno, “Quaderni dell’osservatorio sulla rappresentanza dei cittadini”, n. 7, Rome, Gangemi

Petrocelli Michele (2011), Coesione sociale, etica e competitività: il ruolo del sistema sociale nelle dinamiche competitive all’interno dei sistemi economici e nell’economia globale, Roma, Gangemi


Savona Paolo, Sutija George (1987), Strategic Planning in International Banking, London, Palgrave Macmillan


Stiglitz Joseph E., Greenwald Bruce C. (2003), Towards a New Paradigm for Monetary Economics, Cambridge University Press

Thomas William I., Thomas Doroty S. (1928), The child in America: Behavior problems and programs, New York, Knopf
Sintesi

La globalizzazione rende i mercati finanziari ed economici maggiormente integrati, ma anche più vulnerabili ad attacchi speculativi. In questo modo divengono più probabili crisi di sistema che riguardino intere regioni o, come dimostrato più recentemente, di dimensioni mondiali. Questo comporta che crisi finanziarie, valutarie ed economiche siano così interrelate da alimentarsi vicendevolmente.

Per comprendere queste dinamiche, occorre introdurre nell’analisi economica la dimensione sociale che può spiegare l’attivarsi di crisi speculative e l’instabilità del sistema. I fenomeni delle bolle speculative e delle profezie che si autorealizzano, infatti, sono due delle cause ricorrenti delle crisi finanziarie e valutarie, e la loro spiegazione risale in valutazioni che attengono più la dimensione sociale che quella strettamente economica.

In questo contesto la fiducia gioca un ruolo determinante tanto da spiegare sia le fasi patologiche della crisi che la dinamica del ciclo economico. La fiducia è qualcosa di più complesso delle semplici aspettative individuali, perché si configura con un attributo di un sistema economico, un sapere comune consolidato condiviso di un intero gruppo di persone e da queste utilizzate come ancora nelle proprie decisioni. Rispetto alle aspettative la fiducia è dunque un fatto sociale, ed anche se è formulato come ipotetico, il suo oggetto è percepito come reale ed ineluttabile nelle percezioni delle persone coinvolte. Le narrazioni che un sistema sociale genera sono il tessuto interpretativo della realtà, che guidano le aspettative ed i comportamenti individuali in modo potente, anche al di là di ogni evidenza empirica. Per questo i fenomeni come le bolle speculative si ripetono nella storia con singolare ciclicità, senza lasciare il segno di un’esperienza che possa vaccinare il sistema dal loro replicarsi.

Il ciclo della fiducia, oltre a determinare il ciclo economico, può anche spiegare il verificarsi di moltiplicatori Keynesiani inferiori all’unità (anche asimmetrici). Allo stesso modo, però, consente di leggere la potenza di politiche espansive al di là di questo aspetto, ma considerando anche (soprattutto) gli effetti sociali e le narrazioni che possono portare con sé.