

## **Bailout or not bailout during recession**

**Syed Ahsan Khursheed**

*Associate Professor of Economics*  
syedahsankhursheed@gmail.com

**Syed Muhammad Affan Qadri**

*Student of BBA, IoBM, Karachi*  
affansyed10@gmail.com

### **Abstract:**

*This paper is written to present the shortcoming of capitalism to stabilize the economy from recession and Covid -19 pandemic. The capitalist economy is on the brink of its collapse is the main argument of this article. After establishing this argument and the reason behind this collapse, which is the debt-oriented economy and domination of the financial sector over the non-financial sector. I present my alternative Islamic solution for Pakistan under this pandemic condition. My fundamental demand is that the GOP immediately repudiate all its financial contracts, both bilateral and multilateral. All the policies regarding the liberalization of the economy immediately stop and domestic policies for our national interest should be implemented.*

*Key words: recession, bailout, capitalist economy, liberalization, economy, Keynesian Economy, classical economy*

## **Introduction:**

In the catastrophic event for the economy, such as the recent recession and pandemic of coronavirus, the only viable option for the market economy is the bailout. Why is this the only option available within the framework of a capitalist economy? The evolution of the capitalist economy from the classical period into the neoclassical period is the key to understanding the response.

### **Classical economy assumption and the role of government**

The classical economy is a market economy main thinkers are Adam Smith, Ricardo, Mills. **(Brien, 2004)** The goal as determined is freedom, equality, and progress, which is postulated by **(Smith, 1853)**, **(Malhotra, 2009)**. The concept of self-interest was driven by Smith, not from the Christian concept of sympathy but drove the meaning of sympathy from Hobbes and Locke (17<sup>th</sup>-century philosophers), both believed that human nature allowed people to be selfish **(Lloyd, Sharon A., and Sreedhar, 2019)**. Robbins stated that although human desire is limitless, there are only so many resources available to satiate it. Therefore, microeconomics focuses specifically with maximising utility under the constraints of limited resources (Brien, 2004). Maximization of desire is nothing more than capital accumulation. The law of nature is nothing more than the law of capital, and capital is desire for its own sake, so the accumulation of capital is the actualization of Liberty or freedom. The producer's goal is to maximise profit or capital accumulation, but in the product market, investment is first converted into a product before being transferred into profit. Because profit is very uncertain and fragile, the capitalist market transforms into a financial market where capital is accumulated due to interest even when there is no production. The primary financial markets are the money and capital markets. Because the financial market accumulates capital quickly, the product market will become subordinate to the financial market. All decisions are based on the financial market or capital accumulation. (Ansari, 2017). The classicalist

**Keynesian Economy after 1930 Great Depression.**

The classical economist claims that the government will not intervene in the market and that the market will immediately stabilise with the help of the Invisible hand, which is self-interest. The government's role in this free market is not to stabilise the economy, but to pass legislation that benefits the market. During the Great Depression of 1930, the market was unable to stabilise itself, and the self-correcting monetary policy theory was proven false. During that time, Keynesianism emerged and correctly predicted that automatic stabilisation would not occur because another market, the speculative financial market, was emerging. During that time, he suggested that the government play a critical role in preventing the economy from falling into recession. Fiscal policy, rather than monetary policy, will be crucial. The government will spend more, and as a result, the private sector will gain confidence and invest more in the economy, causing the economy to stabilise. Market speculators will gain confidence, and market speculation will turn positive. Because of government spending, private investment will rise, boosting growth. Keynes employs the adaptive expectation approach and proposed that the market is never in equilibrium. Unemployment and an inflationary gap will result from economic disequilibrium. The Keynesian economy remained very strong, particularly after WWII. The entire government is free to decide on fiscal and monetary policies, as well as the exchange rate. The exchange rate is determined by gold reserves, a fixed exchange rate, but after World War II, an institution called the Britain Wood institution emerged to allow for centralised monetary policy, as a result of the Bretton Woods conference. It was proposed at this conference that all currencies be pegged to the US dollar rather than gold. Two institutions were established as a result of this system. The first is the IMF, and the second is the World Bank. When the US economy went into recession in the 1970s, the Bretton Woods system imploded.

**Neoclassical assumption and role of government.**

After 70 years, the Keynesian economy is unable to provide a solution to the American recession. Following that, the government's role shifted. Instead of having a fixed exchange rate, the rate becomes floating. The exchange rate is linked to the baskets of some powerful currencies. This is known as the neoclassical period of economics, during which the economy was completely liberalised and decentralised. All governments are no longer sovereign; monetary, fiscal, and trade policies are determined by international organisations and the United States. The International Financial Institutions and corporations ruled this market economy. Financial institutions are becoming more liberated and dominant. Instead of adaptive expectation, rational expectation takes precedence. Rationality is nothing more than the pursuit of liberty and capital accumulation. (Simon Clarke, 1988)

**Recession and the role of government.**

During this time, two recessions occurred: the 2008-9 recession and the current corona virus-related recession. In both cases, all governments have only one solution: a bailout programme to protect multinational corporations and financial institutions. Governments bailed out those industries in a \$500 billion bailout package approved by the US government in 2008. Due to the Coronavirus, the US government recently approved a \$2 trillion bailout package. All developed and developing countries will bail out international financial corporations. IMF During this period, the World Bank and other multilateral and bilateral agencies forced the local government to bailout instead of stabilising the national economy. International financial corporations will make decisions based on their own interests, and all nations must follow them. The IMF predicted in its October 2019 annual meeting that the global economy would be on the verge of a major recession in the next two years. The recovery from the 2008-9 crisis has been exceptionally slow, and regulatory regimes have not been designed to prevent another such crisis from occurring. Growth rates have slowed

across the developing world, and systemic vulnerabilities have grown. Real wages are steadily declining. The debt load has risen dramatically. Exports are falling. Developing countries' competitiveness in global markets has eroded, and trade deficits have grown (Simon Clarke, 1988). The Troubled Asset Relief Program (TARP) was established in October 2008 to alleviate the financial crisis. A \$ 700 billion fund was established to purchase the troubled assets. These funds were used to inject equity into those troubled institutions. These funds were primarily used to save financial institutions as well as large capitalist corporations such as GM and Chrysler. ALAN, S, BLINDER; MARK, 2010 correctly identified that automatic stabilisation is not possible during a depression and that the government should step in. The capital purchase programme (CPP), which is an equity infusions programme, has also been very successful in conjunction with the TARP programme. Alan 2010 provided some statistical evidence that the US economy is recovering as a result of the infusion of these programmes and some fiscal relief. (ALAN, S, BLINDER; MARK, 2010) as a supporter of policies stated that Keynesian policies are still applicable. The financial sector has a speculative problem during the recession period, and when the public speculates that companies and financial institutions are going bankrupt, everyone demands liquid assets, which is referred to as the liquidity problem. As a result, when the entire public follows the same path, liquidity quickly evaporates. The financial market has no liquid; they have invested or landed more than they have in liquid; thus, this crisis is a liquidity crisis. The Capital Purchase Program, which provides liquidity to the financial market, appears to be the only solution for the capitalist world. According to them, the bailout will not solve the problem because banks are unwilling to lend and businesses and consumers can't or won't borrow. The problem is that this has no effect on hoarding, and the nominal interest rate cannot be effectively negative; this is known as the liquidity trap. This bailout may save the corporations, but it does not guarantee the recovery of the economy as a whole.

### **Policies of the Government under recession and covid-19 pandemic**

COVID-19 triggered a new phase of the recession. The US government approved a \$2 trillion rescue package. \$1.8 trillion for the private sector, \$62 billion for the airline industry, \$17 billion for "national security industries," \$659 billion for the Small Business Administration's (SBA) Payment Protection Program (PPP), \$500 billion for the Primary Market Corporate Credit Facility, and \$600 billion for the Main Street New Loan Facility, Main Street Priority Loan Facility, and Main Street Expanded Loan Facility. Some of the bailouts are grants, while others are loans; the airline received half grants and half loans, while PPP received all grants. These bailout programmes' debt components do not have market interest rates. This policy response is currently being debated. The difference between this Covid-19 and 2008/9 is that banks and other financial institutions were the primary recipients in 2008/9. The Keynesian solution to the Great Depression of the 1930s is not a bailout; rather, he recommended fiscal policy rather than money as a solution; his solution is accelerator or multiplier work as a visible hand (government) rather than the invisible hand of the market. The government must stabilise the economy by providing relief to the private sector in the form of tax breaks/subsidies and increasing government spending. This increased private sector confidence, resulting in increased investment and an improvement in the economic business cycle, resulting in an overall boost to the economy (Meier & Smith, 2020).

### **Government of Pakistan's policies before and after Corona-19 pandemic.**

Prior to the Corona pandemic, Pakistan's economy was forced by the IMF to participate in the Extended Fund Facility (EFF) programme, which resulted in a massive devaluation of its currency. This devaluation was carried out in order to increase exports and thus reduce the current account deficit. However, studies have shown that our exports are price inelastic, so exports will not increase, but import goods will become more expensive, and our debt burden will rise. GDP growth, on the other hand, has slowed from 5.6 percent in 2018 to 3.3 percent in 2019. Without accounting for the pandemic, it was expected to fall to 2.4 percent in 2020. Meanwhile, due to revenue shortfalls, the fiscal deficit problem

persists, and the government reduced developmental expenditure to achieve a positive primary balance, which was one of the IMF program's conditions. (Sareen, 2020)

Pakistan's economy is suffering as a result of the coronavirus outbreak. Experts predict that the growth rate will fall from 2.4 percent (FY 2020) to 1.1 percent, or even be negative. The fiscal deficit will be reduced to 10%. According to the PIDE study, poverty has increased by 59 percent, with 125 million people living below the poverty line. According to the IMF, the federal government's debt has increased from 80.4 percent of GDP before the pandemic to 85.4 percent afterward. Government policy is based not only on obtaining debt relief from external debt, totaling US \$ 107 billion, but also on anticipating bailouts from bilateral and multilateral agencies; already in 2019, Pakistan has received US\$ 9 billion in bailouts from countries such as China, Saudi Arabia, the United Arab Emirates, and Qatar. In March 2020, the GOP announced a PKR 1.2 trillion package from these funds. PKR 150 billion was allocated to the most vulnerable families, PKR 100 billion to SMEs and agricultural loans for deferred payments, PKR 280 billion to wheat procurement, PKR 200 billion to labour, PKR 75 billion to lower petroleum product prices, and PKR 100 billion to the export sector. In addition to these benefits, the SBP reduced the benchmark policy rate from 13.25 percent to 9 percent. However, the problem with Pakistan is that the government is heavily reliant on outside assistance, but because the pandemic is widespread, donor countries are also providing massive packages to their economies, leaving little room to assist other countries. The IMF's EFF programme is currently on hold, and the PTI government is attempting to renegotiate it. Instead of relying on its policy to combat the Pandemic, Pakistan is acting like a bagger, completely reliant on foreign funding.

The primary source of the recession in the capitalist economy is financial speculative local and global institutions. As previously stated, these institutions are no longer subject to any government regulations. They are not governed by any state other than the United States. The most popular slogan in developing economies is financialization of the economy, which is defined as deregulation of financial markets, liberalisation of capital transfers, and

privatisation of the banking system. The financial system's role has gradually shifted from loan-based financing of non-financial corporations to more market-based activities and speculative operations, while non-financial corporations have become more involved in financial activities. This will result in artificial asset bubbles and debt-driven economic growth. Consumer financing provides loans for household consumptions, and the developed financial market has captured every market. Debt-income ratios and corporate debt-equity ratios are rapidly increasing, making the economy financially fragile and potentially unstable. The result is the severe financial and economic crises that began in the developed economy in 2007. The main cause of the crisis, financialization, has yet to be addressed by either the developed or developing economies. If the economies are unable to address this problem, the capitalist economy will collapse, and the Covid-19 crisis will hasten the process. (Grilli et al., 2017)

### **1. An alternative solution for Pakistan under the current prevailing situation.**

- Immediately repudiate all the IMF programs particularly the EFF program and immediately demand the fair and free audit of all the IMF programs as done by many African and Latin American Countries.
- Growth of the domestic economy by enhancing the domestic demand rather than external sector demand.
- Immediate cut down of the government administrative expenditure and focussed on productivity growth, reduction of the public bureaucracy by 50 percent at the federal and provincial levels,
- Promotion of the halal economy which should be completely direct tax-exempt and not subject to state surveillance, promotion of non-usurious and non-gharar financing, the prohibition of mall construction and entertainment business
- Enhancing import substitution in the capital goods and service sectors, identification of export champion firms, targeting technology-intensive goods in the 'right' markets – Iran, Turkey, Malaysia, Africa and their incentivization,

promotion of joint ventures and bilateral supply chains with partners in targeted countries, construction of a targeted protectionist regime, selective tariff escalation and strategic use of NTBs.

- Maintenance of a fixed exchange rate regime, the imposition of strict capital controls on both the current and capital accounts.
- Abandonment of market-based monetary policy and introduction of credit planning, nationalization of all banks and NBFs, implementation of the recommendation of the 1979 Tanzeel-ur-Rahman commission, imposition of restrictions on money market operations, recreation of the Pakistan Banking Council and end to the subservience of SBP to imperialist finance, development of a mass-based tamveeli system
- Government borrowings from SBP to be costless. Borrowings from commercial banks /NBFs to be restructured based on musharka contracts, elimination of commercial bank financing of government current expenditure. NSS (national saving schemes) funds also to be linked to public sector profitability and the CPI involving sustainable subsidization of the NSS program.

## **2. The suggestion was made by the Committee for the Abolition of Illegitimate Debt CAID).**

- The cancellation of external debts of the countries of the region would enable them to free vital resources for rebuilding public healthcare infrastructure, as well as other urgent needs in this economic environment, threatened by sharp drops in income, loss of taxes and revenues, and increased expenditure.
- Permanently cancel all illegitimate debt which should include all bilateral, multilateral, and private debt for all the countries of South Asia especially those under heavy-debt burden with low economic growth forecast.
- Form a citizens' debt audit committee to ascertain the illegitimate part of the debts.
- Citizens should be provided the necessary information on spending for better monitoring and engage them in setting priorities.

- Governments in South Asia must use the additional resources earned through debt relief to strengthen the health system and protecting livelihoods. The resources should not be diverted for other purposes.
- Suspend the payment of household loans and micro-credits until countries are totally out of the grips of coronavirus;
- Replace microcredit institutions by self-managed cooperatives of local populations and by a public credit service granting loans at zero or very low-*interest rates*;
- End privatization of public services and the promotion of Public-Private Partnerships (PPPs) whose ultimate aim is to mobilize public money to nourish the private sector;
- Use this opportunity to mobilize domestic revenue through progressive taxation on large wealth;
- The international financial institutions including the IMF, the World Bank, and other informal groups that essentially feed North/South asymmetries should drastically change the current policies of the lending
- Provide emergency additional finance to the South - excluding *Official Development Assistance* - using zero-interest loans, repayable in whole or in part in the currency desired by the debtor countries;
- Expropriate “ill-gotten wealth” by the elite, the rich, and dominant classes and retrocede them to the populations concerned and under their control;
- Replace the current Official Development Assistance in its current form with an unconditional form of obligations of the developed country as part of the reparation and solidarity.
- Adopt policies for a just transition. ([Grilli et al., 2017](#))

By comparing both the suggestion made by us and by the CAID are seems as same. The difference is that our goal is different, we believe that capitalism is the main evil and against our Islamic values. The goal of capitalism as mentioned above is liberty, equality, and

progress (capital accumulation) which is totally against Islamic values. Ansari rightly said that capitalism is a complete way of life and Islamic is also a complete way of life. Capital is sovereign and accumulation of capital is the ultimate goal as defined by capitalist thinkers like Smith, Locke, etc. (Ansari, 2017). In Islam Allah, the only sovereign authority and the ultimate goal is success in the Akhra (day of judgment/ hereafter). Therefore both Islam and capitalism are contradictory to each other. My aim is the domination of Islam, not capitalism therefore my point of view in principle is different from CAID. CAID consists of social democrats although they are critical of the policies of IMF and World Bank that these policies are against social issues like health, poverty, environment but they are not against capitalism. So we took the criticism to form them but not the goal. The purpose to present both points of view is to show that policies originating from the capitalist institution are not only harmful to us but is toxic for all the humanity, these policies are meant for the hegemony of capitalist institution or corporations.

### **Conclusion:**

World in the post-Keynesian era are facing the recession intermittently and they have only one way out, to provide the bailout to the financial sector. This solution is like a ventilator to the economy but not the permanent cure. This is happen in the developed countries because their economy is over-burden with the financial speculative market. The share of broad money to GDP all over the world was 143.46 percent in 2020, which was only 50 percent in 1990. Decenterlization and liberalization of the economy The challenges posed by the recession and pandemic should be addressed by the thinkers in such a way as to have a long-lasting solution. The bandwagon situation for the underdeveloped economy particularly Pakistan's economy is no longer bearable. Debt and financial sector oriented policies imposed by the capitalist world are challenging by world leaders. Pakistan should immediately withdraw itself from all financial sector agreements. Implement self-reliance and self-sufficient domestic policies which enhance the growth, employment, and other macroeconomic indicators.

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