Taming the Economic Crisis - a Stringent Necessity for Romania

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At the beginning of this century, the financial globalisation, reflected by the integration of capital markets, gained a positive effect by leading the resources to their most productive place, contributing at the same time to the development of poorer areas. However, in time, due to a set of disturbing factors that operated upon the financial and monetary market, there appeared fallouts, present since 2006-2008, that generated the global economic crisis which was reported by some more rational experts, but ignored by banks, businessmen, governments, etc. Today, this crisis acts powerfully, without any concrete signs of improvement and the actions that were taken have failed to mitigate its negative consequences. In this case Romania, respecting the European and global context, must act through the determined effort of all actors of the economic environment in order to overcome this situation, by the improvement of natural resources (particularly agricultural), the growth of absorption of the European funds, the increment of foreign direct investments, the increment of competitiveness, reducing unemployment, reforming the administrative system which is too expensive under current circumstances. This challenge can be done if we bear in mind that during these years of crisis Poland has succeeded in achieving economic growth using concrete measures and leaving aside group interests.

Key words: unregulated finances, disturbing factors, financial globalization, out of the crisis, harmonized measures, public debt, fiscal consolidation
JEL codes: E 44, E 52, F 43, G 32, O 16

Introduction
Liberal ideas that the markets, particularly the labour and financial markets can adjust themselves, proved not feasible, generating major imbalances that culminated with the global economic crisis. Experience has demonstrated that “neo-liberal inspired financial reforms, based on deregulation and globalization of financial markets have increased the access to financing and the possibility to commercialize assets” [1], causing major imbalances. The economic crises are the result of major imbalances between production, demand and distribution. The increasing of the obtained profits was due to the gaining of some products and services with the help of cheap labour force that was the result of the liberalization of the labour force from the less developed countries. On the other hand, the absorption capacity of this production has less grown, generating major imbalances in the exploitation of the achieved production. As a consequence of this situation, those with poor incomes were encouraged by the banks to run into debt in order to buy products and services considered to represent a normal consumption nowadays. In this context, “people felt the social pressure to consume more because everyone else was doing it, and they don’t want to remain the last and they don’t wonder if they can afford such a level of consumption because no one else wonders about it. Meanwhile, people consume beyond measure and make bad investments”. [2]

This crisis has arisen due to financial and stock market’s speculations on which some experts drew attention, but no one paid attention to them. What Nouriel Roubini commented on in 2006 about the Euro zone and Italian economy seems that almost comes true, writes the Business Insider magazine on November 12th, 2011. The lack of serious economic reforms in Italy shows that there is a growing risk that this country could end up like Argentina.

“The privileged status that the financial industry possesses in the current economic management proves this situation: finances extract an undeserved rent from the rest of the economy” [3]. This led to the situation where unregulated finances formed a destabilizing element of economy and the economic crisis obliged governments to save banks, affecting the continuously eroded incomes of most people.

One of the causes of the current economic crisis was the reduction of the rate of interest which generated a monetary expansion promoted by the U.S. Central Bank (Federal Reserve System) during the years 2001-2008. This situation gave rise to a cheap artificial credit on the basis of which imprudent investments were made. The same cheap money policy was adopted by Japan who permitted banks to supply with low-interest money. Charmed by the illusion of economic growth, the European Central Bank has cut the rate of interest at approximately 2% for many years.
In the USA, the banking system recklessly encouraged credit towards larger groups of debtors, with mortgages guaranteed by the government, under the political slogan “a home for everyone”. In this case, the extremely low interests crashed the incentive to save, causing the overgrowth of loan and consumption.

The responsibility of disturbing the normal functioning of economy falls upon the monetary authorities which periodically injected cheap capital from the bank presses. This fictitious economy-advanced capital had undesired effects in the plan of redistributing earnings. It was noticed that this governmental policy generated over-indebtedness to those who we advised to take cheap credits that finally proved to be disadvantageous. The illusion of prosperity generated by the fictitious capital and by the injections of liquidity didn’t last long and the moment of truth eventually arrived. The real-estate bubble, appeared based on these credits, has burst, generating disastrous situations for those who couldn’t pay their debts anymore.

In this situation, governments have helplessly witnessed to the creation of some sophisticated financial products that offered the illusion that one could live better on debt. This was compounded by the huge salaries paid to the bank managers and to the managers of multinational corporations, fact that further polarised society. The banking system and its toxic “engineering” became an inflated sector laid on an insecure foundation, like a cubes game, whose collapse once triggered in America resulted in a turmoil that was widespread all over the world, generating the most powerful global economic crisis.

Regarding banks’ major mistakes in triggering the current global economic crisis, during an interview with Bloomberg, published in Corso.ro on July 10th, 2012 Nouriel Roubini makes the following acid remark: “Banks’ instinct is still that of cheating or doing illegal or immoral things. The only way to avoid this is breaking these financial supermarkets.” As for who is bearing these damages, same Nouriel Roubini remarked: “Nobody has got into prison from the beginning of the financial crisis. Banks break the law and the highest possible penalty is a fine. If certain people got into prison, it might be a lesson for other to learn”.

Through their present day activity, European banks have not fulfilled their duty to provide inputs for the real economy and private investments, as percentage of GDP, have decreased in the last years, creating problems for the Euro zone which is dependent on the success of small businesses. Today there are four elements that maintain the global economic crisis:
- the slowdown of economic growth in USA;
- the unresolved problems due to public debt in Europe;
- a slowdown in emerging markets, especially in China;
- military conflicts in Iran and Syria.

**The contribution of European Union’s Fiscal Pact on breaking through the economic crisis**

In the Euro zone, the highest challenges are represented by the sovereign debt crisis and the banking risk. This is why fiscal consolidation is essential, not only for countries that have received aids from IMF and EU, but also for countries with high budget deficit. The strategy to overcome the crisis of the public debt in the Euro zone is based on the Treaty on European Stability Mechanism (EMS) and on the new Treaty on Stability, coordination and governance in the economic and monetary union (called Fiscal Pact).

Today we are all concerned to take actions that can take us out of this prolonged crisis. As a result of these concerns, the countries of the European Union agreed, not without arguing first, that it is necessary to establish and respect some principles that can solve this problem, and these principles materialized into the Fiscal Pact. This document introduces a set of rules in the EU that can improve the budgetary discipline, also providing automatic penalties for the 25 countries that signed it (an exception is made for Czech Republic and Great Britain who are not joining the treaty).

The EU fiscal pact, enforced in March 2012, establishes the threshold of 5% of GDP as a limit of the structural budgetary deficit, and if the level of the public debt goes significantly below 60% and there are no risks regarding long-term sustainability of public finances, this structural deficit may reach approximately 1% of GDP. When there is a divergence from this objective, a correction mechanism, by which a Member State will be required to implement measures to comply with the established limits, is automatically triggered. Financial penalties will not exceed 0.1% of GDP. According to this treaty, only countries that sign and ratify this act can profit by funds from the European Stability Mechanism in case of need. The maximum cyclic budgetary deficit plus the structural deficit will fit up to 3% of GDP.

Accommodating to today’s Europe, the new French president François Hollande, who initially had reservations, doesn’t necessarily want a renegotiation of the Fiscal Pact, but he pleads for the expansion of the agreement with elements concerning the stimulation of economic growth. Referring to this document, Clemens Fuest, a professor at Oxford University and advisor to the Federal Minister of German Finances,
demonstrates in Deutsche Welle, on June 26th, 2012, that the Fiscal Pact is perceived as a tool of blackmail, based on the fact that the government of Berlin claimed that only the countries who approve of this document can be supported through the European rescue funds mechanism (ESM). “Perhaps we should think what are the chances for a regulation to be respected while it appeared through blackmail”, says Clemens Fuest.

Regarding the Fiscal Pact, major decisions were adopted at Brussels to allow EU member countries to consolidate economies in these harsh conditions of crisis. Among these, we mention the most important ones:

1) The possibility of direct capitalization of money through the European Rescue Fund (ESM), provided that a control mechanism is brought into being, supported by the European Central Bank;
2) The quick approval of the program of rescuing the Spanish banks;
3) A more facile access to European rescue funds of countries that comply with the reform and economy plans established by Brussels;
4) The development of EU on 3 levels by building up a banking union, a fiscal union and a political one.

Referring to the stipulations of the Fiscal Pact, a total of 171 prestigious experts in finances and economics, supported by Hans Werner Sin, the president of the Institute of Information and Economic Research near the University of Munich, point out that the Fiscal Euro-Pact will not be a shield against the loss of wealth. In this context it is argued that Wall Street, the City of London and the Parisian banks were rescued through the decisions taken at Brussels in June 2012, while Germany underwrites the pay of debts of Southern European countries. “The German state is pulled deeper into the Southern crisis and investors worldwide, who scammed each other in their financial speculations, can calmly rescue themselves in the last second of the vortex”, shows this study.

In the economists’ open letter to German citizens and politicians, it is stated that “Tax-payers, pensioners and those who possess economies, from countries of Europe that are still strong, cannot be asked to underwrite these debts, especially when huge debts are foreseen, resulting from the financing of inflationary bubbles of the Southern countries. Banks must fail. When debtors cannot repay the money, there is only one who can suffer the consequences: the creditor himself, because he made investments while knowing the risk and only he possesses the necessary money”.

**The Polish lesson should be considered for getting out of the crisis**

Despite Europe’s harsh climate in the past five years, Poland is the only state without recession. Therefore, during 2008-2011, Poland achieved an economic growth of 16%, double as compared to the average of EU, with the help of a fiscal policy based on austerity and on the reduction of the ration between the public debt and GDP. In 2012 this country will achieve an economic growth of 4.3% and according to experts’ assessments there will be a growth of 2.5% in 2013.

Poland has brightly achieved to avoid the recession by its capacity to adapt the internal production and by the particular consideration it gave to the privatization process. Thus, in the last ten years, unlike Romania who sold many factories at a loss in a moment when the economic crisis lowered their prices, Poland chose a different version. Whenever requirements were not fulfilled, the Poles preferred to postpone privatization, to support the development and the capitalization of business and to vend it again later when the market offered a better price. Thus, privatization was a successful business.

**Europe’s exit from the crisis**

At EU level, a body composed of five successful economists who offer assistance to the Government in Berlin, proposed the creation of a Joint Liability Fund that can accumulate the sovereign debts from countries where they exceed 60% of GDP. These debts are transferred into a fund guaranteed by all countries in Euro zone, while each state takes on a plan of fiscal consolidation. Currently, the fund volume is 2.300 billion euro, of which Italy has the largest debts, of 950 billion euro. These debts could be placed on the capital markets in the form of common bonds and the states that borrow shall have a repayment period of 20-25 years.

The advantage of this mechanism would be that it is limited both in time and volume. Such a fund would help to redress the budgets of countries in difficulty as today the interests that Spain and Italy must pay to the loans taken for a period of 10 years are of 6-7%. The advantage of the indebted countries would be the time they’re gaining, as the debt repayment pact offers them the possibility to elaborate and put into practice the structural reforms needed for recovery.
At the same time, Germany and other EU countries with high reliability should accept higher refinancing costs. This would mean a return to normality, as the rising interests that these countries pay when contracting long-term loans are due to the turmoil that the crisis provoked on the loan market.

The joint liability fund represents a mechanism that contains three security elements:
1 – the control of state debts to be granted by the Constitution of each state;
2 – the payments to the fund to be guaranteed by a national surcharge which will detour the treasury and it will be paid directly into the fund.
3 – the national reserves offered as a guarantee (gold or foreign currency).

In the context where Europe, with all actions taken, could not overcome crisis, we should bear in mind the idea that China is willing, provided full risk assessment, to continue to invest on the euro debt market and to continue its discussions with EU, the European Central Bank, the International Monetary Fund and other key institutions, in order to help the indebted countries from Euro zone. Beijing officials have repeatedly stated that they support a stable euro and according to most experts’ estimations, a quarter of China’s exchange reserves, amounting to 3.200 billion dollars, are invested in the European currency.

In order to avoid the negative situations existing in the financial sector, it is necessary to implement more precise regulations, able to create a more favourable environment that should take into account the following:

a) the control of incentives given to bankers who defy any man of good faith;
b) the separation of banking activities according to the type and level of involved risk;
c) the establishment of regulation of responsibility and transparency in the international financial operation;
d) the insurance of more favourable conditions for the increasing of the level of competition in this sector.

The condition in Romania

The procyclical fiscal and budgetary policies adopted by the Romanian government had the effect of increasing the budgetary deficit and public debt. In this way, long-term obligations of the public budget were created, making impossible to quick adjust the reducing of costs.

During 2002-2007 “people earned more, but not as much as they could afford the level of consumption they desired.” [4]. To cope with this situation, most people resorted to loans that have generated economic growth based on consumption, resulting in the brutal increase of current account deficit and public debt. In other words, more vehicles, appliances, electronics and so on were bought, but this did not encourage the Romanian economy but the foreign countries’ economies, from where all this goods were imported and it caused the increase of the current account deficit.

The external capital flows entered in Romania in the last ten years are often volatile and in many cases they generated imbalances. Unlike these ones, domestic saving is more stable and when cleverly used, it generates a sustainable economic growth. According to data provided by the European Commission, in 2000-2008 saving in Romania was about 17% of GDP compared to 30% of GDP recorded in the same period in the industrialized countries from Asia. In the next period the situation improved, therefore in 2009-2010 the percentage was 21% of GDP and 24% of GDP in 2011.

Technically, Romania entered recession in 2009, when GDP dropped for two consecutive quarters, compared to the same quarters of the previous year. This year, GDP was 491.2 billion new lei (115.9 billion euro), dropping compared to 2008 due to lower volume of gross added value in all sectors. The total final consumption decreased by 8.2%, mainly due to the reduction of 10.8% of costs for the final consumption of households.

In 2011 GDP was 119. 8 billion euro, exceeding the previous year. This year, construction has been the industry that recorded the largest increases of workload, with 5.7%, followed by agriculture, forestry and fishing, with 3.1%, industry with 2% information activities and communications with 1.7%, etc.

According to economic forecasts of the European Commission, in 2012 Romania will record an increase of 1.4% of GDP compared to the last year 2.5%, and in 2013 the indicator will reach at 2.9% of GDP.

Romania’s exit from the crisis

The situation of both Romanian and global economy shows that the exit from the crisis cannot be done overnight and that this is a difficult process. In order to tame this crisis we must call for reason,
which requires the joint effort of all Romanian stakeholders, given both the international economic context and the condition of our country.

For Romania, the exit from the crisis requires putting into practice a set of harmonized rules that should consider:

1) identify and encourage those sectors that represent a competitive advantage over other countries, such as: agriculture, IT, renewable energy and so on, based on a coherent strategy that will not be changed by every minister or government and that will be applied for at least 10 years.
2) encourage the consumption and investments;
3) the revival of the industry as an economic sector capable of generating added value and of finding new extra-community outlets in Russia, Asia, Africa, Latin America etc;
4) attracting more the European funds;
5) further restructuring in the budgetary sector, which has an unreasonably high number of staff compared to EU countries.
6) increasing the competitiveness of products and services for domestic market and export;
7) decentralization and introduction of standard costs in the budgetary transfer mechanisms.

The importance of investments in overcoming the crisis

Investments represent the material basis of economic and social development of any country, because they provide quantitative and qualitative growth of fixed capital, the increase of technical and economic efficiency of the existing capital, modernization of production technologies, new jobs etc. Investments ensure the increased use of material resources and labour force of the society.

According to the definition given by the IMF, “foreign direct investment means an investment that aims to acquire a lasting interest in an enterprise that is exploited by other one than the investor himself, the latter’s goal being to effectively influence the management of the enterprise in question.”

Foreign direct investments are defined as direct or indirect property of a foreign entity who owns at least 10% of the voting shares of a company. Such an investment may be an acquisition, a merger, a new plant, the expansion of the plant or absorption.

Attracting foreign investments in Romania remains difficult as long as the production costs are uncompetitive due to the poor existing infrastructure and to the lack of implementation of the labour market at corporate requirements, political instability, lack of legal predictability and the unfriendly political climate.

Referring to the foreign direct investments in Romania, the situation is presented as follows:

The evolution of foreign direct investments in Romania during 2004-2011

(Million euro)

<table>
<thead>
<tr>
<th>Year</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value</td>
<td>5.18</td>
<td>5.21</td>
<td>9.05</td>
<td>7.25</td>
<td>9.49</td>
<td>3.49</td>
<td>2.22</td>
<td>1.92</td>
</tr>
</tbody>
</table>

Source: The National Bank of Romania – Balance of payments

In the period under review there has been a growing trend of foreign direct investments (FDI) by the year 2008, except for 2007 when a decrease was recorded. Along with 2009, the decrease gets sharp, representing 36% over the previous year and the trend intensified in 2010 and 2011. This is due to the global economic crisis but also to the inability of the economic and political factors to preserve the existing investments and to allure new ones. In this regard we can observe a lack of active promotion of Romania as an attractive location for foreign investors, an insufficient budget for promotion as well as corruption manifested at all levels. In order to change the negative perception foreign investor have of Romania it is necessary to elaborate laws that attract them, because we all know about the situations in which we witnessed the transfer of business from Romania to the neighbouring countries such as Bulgaria, where conditions are more favourable (smaller VAT, simpler bureaucracy etc.)

As the results of the efforts undertaken by stakeholders in recent time, foreign investors interested in Romania have now at disposal a special Guide to the latest data about the performances and economic potential of our country. This Guide contains 14 chapters and information about our most important economic sectors: automotive, ICT, tourism, energy, pharmaceuticals, aeronautics etc.

According to data from the National Bank of Romania, the FDI volume is lower by 87.19% in the first semester of 2012 compared to the similar period of 2008, recording a decrease from 4.845 million euro to 621 million euro.
Experts in the field show that an increase in investment, equivalent to 1% of GDP would create 1.4 million new jobs in Romania and banks play an important role in their financing.

In Central and Eastern Europe Poland is an example of attracting foreign investors by the educational system that relies heavily on professional schools. In addition, Poland has negotiated with EU a series of facilities for the investors, including tax exemption for a certain period of time, depending on the value of investments. In these circumstances, Poland managed to attract 10 billion euro foreign investments in 2010, compared to 6.7 billion euro in 2009. Also, the Czech Republic left Romania behind, by achieving a level of foreign direct investments of nearly 4 billion euro in 2011.

**Conclusions**

The global economic crisis had as a starting point the overconsumption and welfare on debt, sustained by the banks through shaky financial engineering that only followed immediate gaining, that did not rely on a healthy economy. Today, this crisis acts powerfully, without any concrete signs of improvement and the actions that were taken have failed to mitigate its negative consequences.

The capitalist economy, prevailing today in most countries worldwide “needs a moral compass to guide the behaviour of those who are controlling the private finances”. [5]. It is one of the prerequisites that will help us get through this prolonged crisis and avoid this to happen again in the future.

**Bibliography**


