WHAT WAS NOT RESOLVED BY THE ANTI-CRISIS STRATEGIES IN THE EUROPEAN UNION

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Abstract. *Any economic crisis, where it manifests, involves a forced rebalancing of existing economic conditions at one point. From this perspective, the crisis can be seen as a natural reaction of markets correcting imbalances created by factors that often are closely linked to macroeconomic policies. In this sense we can see the crisis as an opportunity to learn how to correctly manage economies both at national and international level. This paper is an attempt to draw attention to some of the global economic problems, highlighted by the crisis and still unsolved due to various reasons.*

Keywords: *economic crisis, anti-crisis measures, global economy, macro-economic imbalances.*

JEL codes: E44, Q54, E43.

1. Introduction

The European Union has experienced the most recent global financial and economic crisis. As any economic crises that occurred throughout history, this economic crisis has forced some adjustments to restore those natural economic balances that were disrupted by various factors.

It's hard to say how many of the major players of the economy this crisis surprised. At least in European countries, where the economic crisis has made its presence felt after her debut on the American continent, we can say with reasonable certainty that it could have been anticipated. However, at least in words, many policy makers seem to have chosen to ignore this reality looming ever more clearly. If we look at statistics from that time, indicating how much dependency exists between European and U.S. economies and highlighting the local vulnerabilities existing at the

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onset of the crisis, we can easily see that it was impossible for the EU to not feel the effects of such global crises. The explanation for the reluctance of some to announce it can be explained by trying to diminish the feeling of panic or by trying to hide their incapacity or inability to prevent and combat this unwanted phenomenon.

The article is structured in five chapters. Chapter 2 deals with distinct issue of financial regulation in the European Union. It is important to note that both the U.S. and Europe economic crisis originated in the financial sector. This particular sector is one requiring more regulation, given the magnitude of adverse effects that failures of major financial intermediaries may cause on the whole economy. Chapters 3 and 4 relate to other issues in the European Union that stressed the negative effects of the financial crisis of 2008, in particular the issues related to fiscal policy and the large discrepancies between Member States and macroeconomic vulnerabilities. It is particularly important to understand what problems were solved and what remains to be done in order to avoid future crises and to be one step closer from the dream of a strong and united Europe. The last chapter is dedicated to conclusions.

2. Financial regulation

The financial sector is of particular importance for the economy because it provides the transfer of resources in an economy. For this reason, most of the problems in the financial sector are transferred very quickly throughout the economy. This is the mechanism through which a financial crisis turns into an economic one. An important vulnerability related to the financial systems faced by countries around the world refers to their enormous size. A highly developed financial system is not necessarily a bad thing, but it is a very serious argument for the need of proper regulation. The graph below illustrates, for selected Member States and EA18, the size of the financial system calculated as ratio of total liabilities of financial sector in the total GDP. One can easily see that the situation has not changed significantly in the European Union since the beginning of the financial crisis. Virtually all EU states have tried to save their institutions through measures that ensure liquidity in the system. The chart below can give us an idea of how difficult it can be for the state to intervene in the field of financial sector.

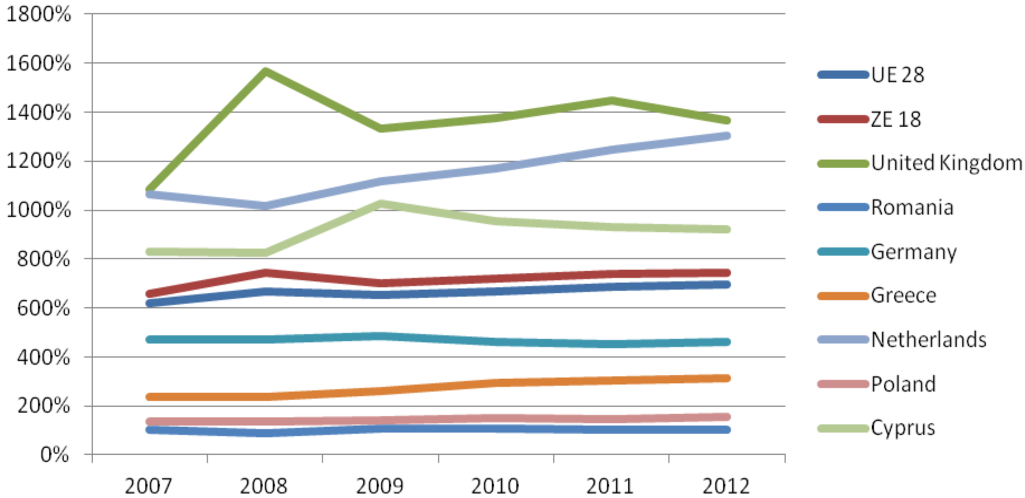

Chart 1. The share of financial sector liabilities in total GDP (%)
– Unconsolidated data –

Source: Eurostat

Regulation of the financial system must be adapted to the specific conditions of each economy and made in such a way that it doesn't inhibit the specific feedback mechanisms of free markets. An over-regulation entails many problems, the most important being caused by the fact that a mistake from the center is transmitted throughout the system without the chance of being corrected by the individual decisions of players in the market. Certainly any regulatory authority in any field should consult before taking a position with all parties concerned by that measure. However the problem still remains.

In the European Union the financial crisis was installed through two main channels. There were loans too easy granted in some Member States, a fact that is due to inadequate prudential regulations in those countries. But the main cause of the financial crisis in Europe was the financial instruments purchased by European banks from the U.S. markets. The financial crisis was felt soon after the fall of these markets. Management practices of banks on the old continent proved to be too reckless in their behavior of risk taking. Unable to lend as easily as in the U.S., but being attracted by the huge profits and bonuses in the US, they somehow managed to import a large part of America's financial problems.

No doubt this damaging behavior is largely due to specific corporate governance of European banking systems. Here arises the question whether the state should intervene in corporate governance in private companies. Until the financial crisis, the opinion supported by the majority of economists and macroeconomic policy makers was that corporate governance should remain the sole responsibility of shareholders. This is one of the ideas that the crisis seems to have changed. Currently, the European Union is implementing a series of measures to improve the quality of corporate governance in the banking systems. If these measures are properly implemented, this is one of the issues that can be considered solved.

However corporate governance is not the only problem of financial sector regulation. First, it is important to note that banks are only a part of the entire financial sector of an economy. This sector also includes insurance companies, pension funds, various other investment funds, leasing companies and other entities with a role in financial intermediation. In our opinion, one of the problems with financial regulation is that it is not uniform across the entire financial sector. Banks are the most heavily regulated because they invest money from attracting deposits, guaranteed to a certain limit and with “zero” risk normally considered by many. The policy of commercial banks has also an important role in the evolution of broad money. Both the U.S. and European Union financial problems came also from other financial intermediaries than commercial banks, the crisis highlighting the strong links between different types of financial institutions. In these circumstances, it is very important for the competent authorities to extend the measures to improve corporate governance across the financial sector.

Another welcomed initiative in European regulation of the financial system was the lack of standardization in all Member States. The idea of creating a single system of prudential supervision is a good one because the recent crisis did not care about any border and some Member States were forced to intervene on behalf of others to maintain overall stability in the European Union.

An unsolved problem globally, not only in the European Union, is the need to inventory all financial instruments and to keep only those that are useful. We don’t have to see anymore similar tools to those mortgages backed securities (MBS), with extremely attractive yields.

3. Issues of fiscal nature

The reason that the financial crisis installed so quickly in Europe and was so hard felt by its residents was that it overlapped on some internal problems related to fiscal discipline in almost all Member States.

The mechanism to ensure fiscal discipline in the European Union before the crisis was the Stability and Growth Pact (SGP). The agreement involves monitoring Member States fiscal policies by the European Commission and Council of Ministers, and issuing annual recommendations for political action. When a Member State violates the maximum levels established (public debt to 60% of GDP and a budget deficit 3% of GDP), an excessive deficit procedure (EDP) through which the Member State receives some recommendations to correct imbalances. Otherwise financial sanctions could follow. The main purpose of the pact was to ensure the primacy of fiscal responsibility, and limit the ability of governments to exert inflationary pressure on the European economy. However, pre-crisis reality shows that this mechanism does not work, Member States often violating the limits. More serious is the fact that states did not all equally violated these limits, thus creating issues including monetary policy in the euro area (it must be synchronized with the tax).

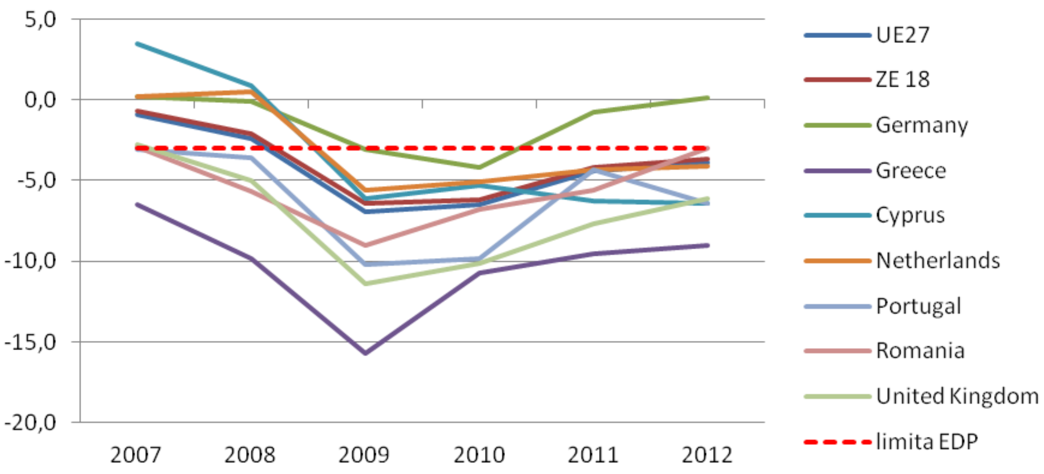

Chart 2. Percentage of budget deficit in total GDP (%).

Source: Eurostat

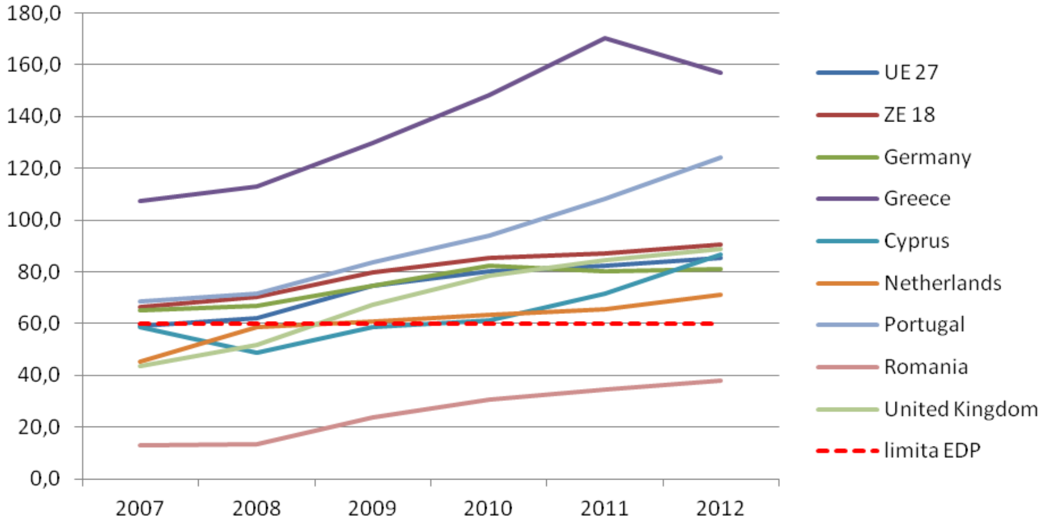

Chart 3. Government debt in total GDP (%).

Source: Eurostat.

The two charts above illustrate the total lack of fiscal discipline in the European Union. The result of these decisions was that in 2008 governments were not prepared to face the financial crisis. The crisis has only served to deepen these problems. Public debt has increased steadily in 2009-2012, reaching the EU-27 about 85% of GDP. However it can be said that something was slightly improved, that most states have reduced their budget deficits since 2008. Nor would it be beneficial forcing short-term public debt reduction because it would mean practically freezing public investment in some areas of utmost importance such as education or the environment protection. This is not a problem to be solved overnight. However the EU should require Member States which exceed those limits to have a concrete medium and long term strategy to reduce public debt and to not increase this indicator further.

In our view, including the limit of 60% of GDP should be reconsidered. The mere assumption of some limits that are breached year after year only produce effects on the bureaucracy in the EU Commission and undermines the credibility of the entire fiscal policies. At least in a medium time horizon, we believe that the share of public debt to GDP limit may be increased.

4. Large discrepancies between Member States

Perhaps one of the biggest European problems is related to the large discrepancies between Member States. This phenomenon is best explained by differences in per capita GDPs. Chart 4 illustrate this indicator. It is noted that recent entrants such as Romania have a real GDP per capita below 25% of the European average and below 20% of that of highly developed countries.

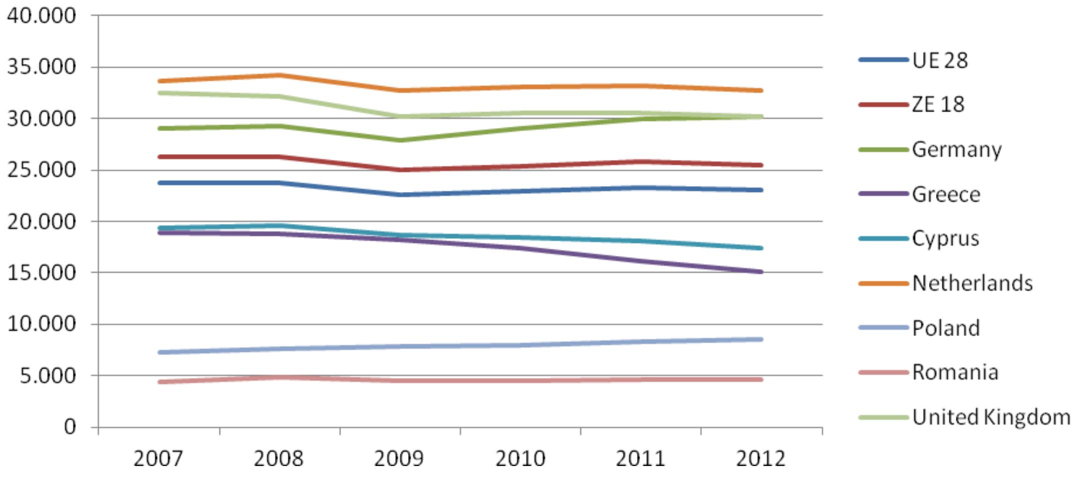

Chart 4. The evolution of real GDP per capita in selected member States (EUR million)

Source: Eurostat.

The solution to this problem continues to be the mechanisms of social cohesion through EU funds. From the above graph we can tell that the differences throughout the financial crisis were largely preserved. Ideal would be to have a clear trend of states with low values to approach medium. But social cohesion is a lengthy process. In our opinion, this process should be accelerated as much as possible by the Member States in view, considering also the geopolitical issues from the eastern border of the European Union.

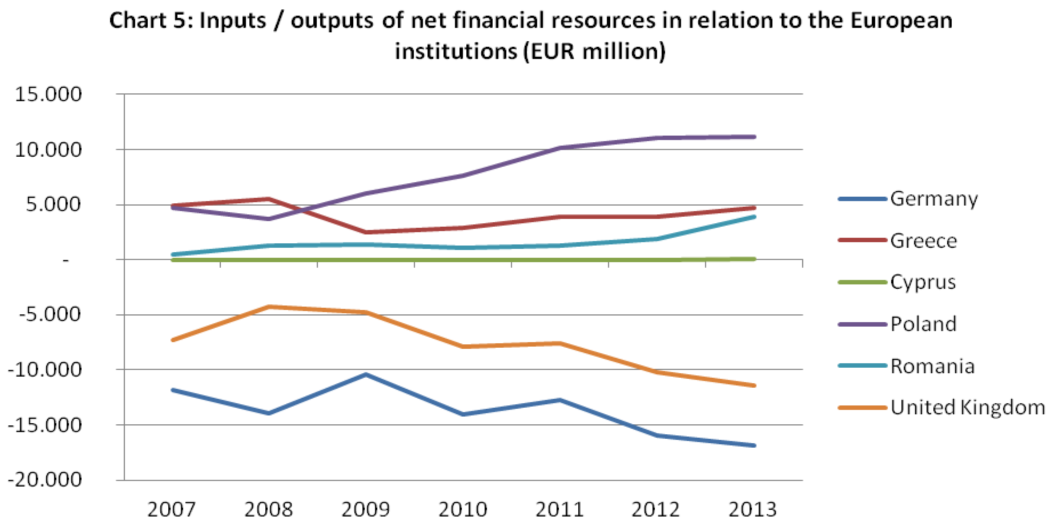

Chart 5. Inputs/outputs of net financial resources in relation to the European institutions (EUR million).

Source: Eurostat.

In this last chart we tried to illustrate the magnitude of the catching up process by the net inflows of financial resources from selected Member States and European institutions. For the most part, the amounts received by countries consist of European funds and the amounts paid represent their contributions to the EU budget, in various forms.

5. Conclusions

Even if we still feel the effects of the crisis erupted in 2008, the European Union seems to have overcome this moment. Lessons that are emerging from this crisis but do not seem to be fully understood by policy makers.

Regulatory measures implemented are good, but not enough. Still financial instruments are traded on exchanges and those who buy do not know many details about them. The possibility of erroneous calculations with huge losses for large financial intermediaries exists. However, changes in corporate governance have produced significant changes in the behavior of financial managers.

The biggest problems remain fiscal discipline and large disparities between countries.

A good thing that seems to have brought the financial crisis is the idea that in order to have a future Europe must be united, because the rules are always made by big players. At least in the area of regulation and prudential supervision things seem to be under implementation.

The developed countries should continue to support the process of catching up for the new entrants, who must close the economic gaps and continue to maintain prudent fiscal policies. This can only be achieved by making full use of all opportunities for growth and development.

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