# THE GLOBAL FINANCIAL CRISIS FOLLOWS ITS WAY

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In the first trimester of 2009 there will be 2 years since the mortgage crisis has started and it became a subject for studies, and hopefully there are chances to pass over until the end of this year. The president of the American Central Bank (FED) Ben Bernanke initiated and implemented a program of measures and new regulations, from which we should mention the followings: decrease of the interest rates in order to calm down the crisis and to avoid recession; to quit using innovative products and the subprime, actions adopted by the former FED President Alan Greenspan; a better cooperation among the Central Banks in order to stabilize the raises; a program of new regulations with more restrictive character, such as documents regarding the applicant revenue, financial reports from the creditors, establishing interest rates for loans.

From all the pressures applied on the economic development by the global financial crisis, the most difficult to evaluate is the duration of this process, forecasted at the end of 2009.

Mr. Edward Balls, member of the British Parliament, considers that the actual recession is the most severe in the last 100 years… The economic situation will powerfully mark the establishment of the political scene in the next five, ten, or even fifteen years. One of the spokesmen of the British Parliament has mentioned that the governmental officials put into light “the speed and the aggression” of the actual crisis.

The concerns of the opinion leaders regarding the effect of the global financial crisis attacking the foundation of the economy, extended a lot and now there are forums and study groups formed by top level scholars where these things can be discussed. For example, Davos Global Economy Forum has such debates each year.

According to his words, professor Joseph Stiglitz, Nobel price laureate for economy, has been participating at Davos debates for 15 years. Having a high reputation, he published from December 12, 2008 to February 6, 2009, three studies, according to free reproduction rights from *Romania Libera* newspaper.

Being ironic, professor Stiglitz has mentioned that the IMF forecast, published at the beginning of the meeting, presents a global stagnation and a very small growth and still was considered an optimistic one. There was a remark from a participant, who said that a forecast with full support at Davos meetings in the end proved to be wrong.

Participants at Davos meeting were asked to offer an answer to the question: “which is the main error that can lead to crisis?”. The answer was: “to believe that the markets improve/correct themselves”.

From the discussions didn’t miss the concept of “targeting inflation”, considered by the participants that distracts attention from more important things such us financial stability, an important factor for development. However the managements of the Central Banks consider that it is sufficient to control inflation in order to sustain the economic growth, the prosperity, and also other relations which aren’t based on substantiate fundamental economical theories.

Sustaining “the American state”, capitalism proved to be different from the “market social economy” preferred by some of EU members and based on the social protection mechanisms.

Professor Stiglitz concluded from his profound research that “globalization permitted American failures to spread all over the globe like a disease”. At the same time “a large part of the money allocated to the banks for recapitalization and to restart credit activity went out of the system for benefits and dividends”. The fact that all over the world the companies don’t obtain necessary loans contributes to the dissatisfactions expressed at Davos. Crisis raised some questions regarding globalization, which was considered a help in order to disperse the risks… However at Davos appeared the concern that globalization, even imperfect as it is, will decrease and the poor countries will suffer a lot. But the rules of the game aren’t the same for everyone.

The second scientific approach follows the American recession “which last for more than a year, and probably will be longer and deeper and will affect all the other countries”.

The USA federal reserve is in action from the beginning of the process and the first measures were an excess of liquidity and lax regulations, corrected by raising the liquidity in the economy and preventing the fact state. The premises for a economy decrease already appeared, and now the situation will deteriorate.

Global economy is facing major problems, so, we cannot expect to have an important growth anytime sooner.

For a long period of time USA, one motor of the global economy, managed the situation with its own resources, this is one reason the world should be grateful for. Without this participation we wouldn’t have the necessary level of global aggregate demand.

For a while, the excess of liquidity was considered a good thing, but this was only one thing which worried Keynes, namely the insufficient level of the global aggregate demand. At the same time, the American Government will succeed to partially compensate the increase consumers’ savings from USA. If the consumers can pass from a low level of existence to a modest one, pressure on the demand, added to the on the effect of the investments, if the exports and public expenses would decline, then the process will be with no counter-weight.

For the actual crisis very little is done, that’s why the causes of the instability from the USA economy couldn’t be avoided. Problems tackled by professor Stiglitz represent only a part of his study.

As a member of the group which turns to be from the Keynes traditions for over three decades, J. Stiglitz considered the event “a victory for reason and scientific proofs over ideology and interests”. The author considers that the uncontrolled markets don’t correct themselves and need regulation for this meaning, and the state fulfills its role in the economy. However, those who worked for the financial markets established the market fundamentalism. From Keynes point of view markets in severe decrease imply risks for fiscal policy instead of monetary policy, some risks which are useless.

In USA, a huge and uncertain private debt and a decrease of taxes wouldn’t produce effects. In some certain cases a large part of taxes decrease are absorbed by savings. Professor Stiglitz’s study presents also some social problems. The heritage of lack of investments in technology and infrastructure – especially the “green” one and the gap between poor and rich people, followed by the harmonization of expenses on short term and a vision on long term …A tax decrease for poor people and the increase of the unemployment indemnity, applied simultaneously with a raise for the rich people could stimulate the economy, reduce the deficits and blur the inequalities. Keynes feared for a trap of liquidity – the incapacity of the authorities to determine an increase for the offer on loans market in order to raise the level of economical activity.

Regarding the theoretical exchange Stiglitz underlines that banks pass from credit business to moving capital business resorting to buying and selling assets which finish with incompetence records in risk and worthiness analysis. Significant for research is the following situation: in all of this time it is done very little to help banks in what they have done – this means to offer loans and to evaluate "worthiness". Taking into consideration these concepts we could say that: "There might be a risk that the new Keynes' ideas can be used and abused in order to serve the same interests".

After the Global Economy Forum in Davos followed the Rome Reunion for the Finance Minister and the Central Bank governors from the Group of the Most Developed Country (G7) as follows: USA, Great Britain, Italy, Germany, France, Japan and Canada. China was invited as a consequence of significant economical progress realized under crisis conditions.

G7 members countries consistently tried to avoid protective measures and abstinence from new impediments of world commerce. The USA Treasury Secretary, Timothy Geithner, trained in numerous international activities, appreciated China results, from the stability of the financial system, to the Roma Summit.

In the large sphere of G7 objectives "protective measures should be avoided, and there should be no impediments for the world commerce". Peer Steinbruca, German Finance Minister said: "We shall do all it is possible to assure that history will not repeat", talking about protective measures.

Nevertheless, in full development of the crisis some protective actions are required. In China the national currency is manipulated in order to obtain advantage for foreign trade. The USA were accused of applying protective measures using the following advertisement "buy American", explicit "for public works only American steel".

Geithner rejected all temptations affirming that: "We all have to sustain a firm commitment of trade and the essential investment politics for the growth of the economy and for prosperity".

The prospective knowledge of the financial crisis evolution was debated this year at Davos Forum in a difficult atmosphere. In Romania since the crises started certain restrictions in financial domain were applied. Nevertheless, for 9 years, starting with 2000 the annual growth was bigger than 5% reported to GDP, with only one exception, 4% in one year. For the first three trimesters of 2008, statistics registered the highest level for GDP growth with figures of 8-9%. Moreover in the last trimester, dominated by sudden crisis, the economical growth was 2,9% reported on GDP. For the entire 2008, the GDP growth was about 7,1%. For the structure of the economy, industry decrease to a minus 7,7% in the last 3 months of the year. Two sectors contributed to this peak of GDP level in 2008: agriculture and constructions.

The sudden attack of the crisis in the South West Europe in 2008 was a surprise. Staring with February 2009, the meetings of the European leaders in BERLIN, discovered that the South East Europe confronted with the threats of a financial crisis. Gordon Braun, Prime Minister of Great Britain, pointed out the pressures of this danger as follows: "We have to act in order to help the Central and Eastern Europe, where series of foreign banks have retreated their operations from the originated market, where to recapitalize the system proved to be a very difficult operation". In some emerging countries, foreign banks reduce their operation on these markets, causing to credit activity. At the same time, the European representatives proposed to double the resources of the IMF. The level of the amount proposed reached the amount of 500 billion American dollars (about 300 billion Euros ). But this meeting didn't establish the increase of the funds dedicated to IMF, but the idea of meeting the demands of the World Bank and Western Governments.

The period after the falling of the Berlin Wall is considered to be the most difficult. In consequence the investors retreat from the region, action followed by the depreciation of local currencies; these movements are simultaneous with the recession from the Western Europe, and favorable to the exports decline.

On February 29, 2009, the Governers from Eastern Europe Central Bank counter-attack.

Four banks (National Bank of Romania, Hungary Central Bank, Bank of Poland and Bank of China) engaged to sustain the currency markets in Central and Eastern Europe, as a reaction to the depreciation of their currencies, pointed out through the negative reports released by International Evaluation Agencies regarding the Eastern part of Europe. This image is the result of reports issued by the international evaluators Moody's, Standard and Poor's and Fitch; these reports made this part of Europe to be seen as the sub-prime zone of Europe.

According to the governor of the National Bank of Romania, Mugur Isărescu, the Central Bank was ready to prevent the destabilized movement of the exchange rate of the national currency, in common accord with the other three governors. Since the beginning of 2009, the Hungarian forint, the Polish zloty, the Czech crown and the Romanian Ron depreciated significantly against Euro. Potential causes: high deficits of current account, dependence upon exports under condition of a restrain demands, and the depreciation of local currencies over the fundament, which is dangerous. As a fact, the common position for the four states has a flexible regime when it comes to exchange rates.

The numerously turning off from the last period presents the Central and Eastern Europe highly exposed to financial crisis effects. Confusing mass reports, can't help the normal evolution, says the governor Isărescu. As consequence he doesn't take any dangerous action in the name of the crisis and he will not imitate measures from the Western Europe. NBR didn't act on the currency market from the middle of 2006 until 2007, but preserves the right to have unannounced intervention for the future. Also the National Bank doesn't exclude a period of appreciation for the national currency.

The Czech Central Bank Governor, Zdenie Tuma, declared that the depreciation of Czech crown and other currencies from Central and Eastern Europe is exaggerated. In Poland and Hungary the evolution of local currencies is not related to the economic concepts.

The Poland Central Bank Governor, Slavomir Skrzypek could react to control instability of the Polish zloty in the economy. The investors restraint depreciated Polish zloty with 12.3% from the beginning of the year. The annalists have some doubts regarding Poland potential to enter ERM II mechanism in 2009 in order to adopt Euro.

The Hungary Central Bank considers that the depreciation of Hungarian forint is not conformed with economy fundaments.

Otherwise the Euro currency functioned only in 16 countries from 27 and volatility for the other 11 European currencies is an obstacle in time of crisis.

On March 200, 2009 the leaders of the EU met in Bruxelles for a debate regarding the crisis challenge on the entire continent.

At the beginning they discussed about the problems regarding finance under course with IFM for the external partners from the East and from the EU outside the Euro area.

The tensions among the members generated some problems of communication, which threatened the European foundation. It was established the contribution of the European block for the IFM financing, how to double the helping fond in collaboration with IFM for the UE economies outside the Euro area and a 600 million support for countries from the Eastern Europe. The accords also contained emergent projects which were received with great satisfaction, confirming the unity of EU against the crisis. In the program were stipulated some measures with protective character, which were subject for critics from other member countries.

In the last part of the first trimester of 2009 the initiatives of the UE and IMF to support the surpassing of difficulties provoked by the crisis are under preparation.

On March 22, 2009 the Inter-minister Committee for debate presented the proposal of IMF to the Government. After negotiations, Romanian authorities, National Bank of Romania and Finance Minister, submitted them to the Government.

Finally, the decision was adopted on the basis of a mandate from the Romanian President.

The main objective of the accord ended with IFM presents the resume of credit activity, simultaneously with suspending the minimum demanding resources for foreign currencies on long term, more than 2 years, set up with the Central Bank. The amounts in foreign currencies released from the central bank are compensated with IMF financing, without affecting the country foreign currency reserve. It is important for the mother banks not to withdraw foreign currencies from Romania.

As the problem of banks foreign currency reserves is complex and difficult to apply, on March 25, one day before IMF mission left Romania, president Traian Băsescu and the governor Mugur Isărescu went to Vienna in order to discuss with Austria president Heing Fischer a problem of mutual interest. In research the necessary reduce of the minimum demanding resources for foreign currencies could determined an exodus of foreign capitals from Romania. This action could take place in Vienna and the major capital belongs to mother banks in Austria: BCR, Volksbank, Unicredit Tiriac Bank and others.

"We don't have banks with difficulties – said president Traian Basescu – but… taking into consideration that the Austrian banks owe more than 30% from the Romanian banking market or that the insurance companies from the same country have more than 40% of the monetary market, we try to set up how to build a partnership between state, government, banks and commercial companies, for a possible depreciation of the economic situation from Europe do not affect the economical evolution from Romania, only as far as we cannot do anything". According to country President and Prime-Minister Boc proposal, through the IMF loan the National Bank could reduce the level of the minimum demands reserve for foreign currencies for commercial banks, with the obligation to use the money for finance activities in Romania. During the meeting from that Monday with president Traian Basescu, Austria president Heing Fischer emphasized that the credit lines for the Austrian banks from Romania "will carry on" mentioning: "Will be some problems which have to be discussed". The credit lines will carry on and also it is clear that will be some problems to discuss, but on the basis of EU regulation regarding the free will of capital.

Before leaving, the IMF mission met the banks presidents: Erste Group, Volksbank, Raiffeisen International, Societe General, Unicredit, Eurom Bank, National Bank of Greece, Alpha Bank, Piraeus.

They will try to see what could be done for Romania in order to obtain a sustain commitment for the banks on the local market.

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After two weeks of negotiating the financial package of initiatives and facing the economic crises, the International Monetary Fund, the European Commission and the World Bank have left Romania and the results of their investigation would be applied at the end of May 2009. The representatives of the financial institutions have decided to maintain the actual VAT and flat tax and also the agreement of our authorities regarding the raise of the budgetary deficit to 4,6%. The salaries and the pensions will be frozen and the new additional income will be assigned to the investments.

On March 25th, the Government has adopted the intention letter sent to IMF, Washington, in order to access the loan. The Prime-Minister, Emil Boc mentioned that the first installment of the loan would reach Romania in May. The agreement was establishing equilibrium between the social and economic structure of the loan. The mutual agreement with IMF states that this year our country will finalize the unitary payment law, including some additional benefits, which will recompensate the employee's work and performance.

Thursday, March, 25th, the head of the IMF mission has presented the main objectives of the external loan, promoted in Romania. Since the beginning, J. Franks has presented the main objectives: ˝We reaffirm – says Frank – our support in order to reach the National Bank's system of inflation till the end of 2009. The inflation target for this date is 3,5%, with one percent variation; the Government proposed this objective for 2010. For the last two years, because of the economic crisis, the Central Bank couldn't maintain the inflation rate". In 2008 the annual inflation rate exceeded 1,5 points, the upper level of the target being 2,8 – 4,8 %. In 2008 the inflation had a slight diminution, 6,3%, instead of 6,57% as in 2007.

The Central Bank would be able to relax the monetary policy conditions when the market will allow this. IMF is requesting for strengthening the banking system, not for changing it. In this context, in two years, the authorities must re-examine with international assistance the system of salaries and pensions in the public sector, together with monitoring and control procedures for the budgetary companies. Salaries in the public sector doubled in a three year period. The new system of salaries will include fewer benefits (these benefits must not exceed 25% of the salary). The Public Fund of Salaries represents 8% from the GDP. The Public Fund has to be under control, underlines J. Franks. The Public system of pensions will become a new challenge. What we need is to change the system, not to reduce the pensions. The pensioners and the employee with low incomes need protection. The pensions will be increased depending on the inflation rate, without taking into consideration the growth of the national medium gross income.

On March, 25th, the IMF Commission met in Vienna with the main foreign banks, operating in Romania. They've been asked to keep the funds in the country.

The problems of the IMF loan are complex and the Governor of the Central Bank, Mr. Mugur Isărescu already follows the ones which are to be solved. The Governor says that Romania should have net input funds – not the present situation with net output. We compensate this with public funds with public capitals.

According to the preparations, Romania will receive 12,95 billion euros from IMF, 5 billion euros from the European Commission and one billion from the World Bank, one from the European Bank for Reconstruction and Development. The process of borrowing will last two years. If in 2008 the incoming of the foreign capitals was 16-17 billion euros, in 2009 we will have an amount of 4-5 billion euros. Gradually we will need an economic adjustment and also an adjustment of the payment balance. In 2009 the deficit of the account current would decrease to 7,6% - 8%, instead of 12% from GDP, as last year. The adjustment has begun last year when the deficit was under 13% from GDP.

Carrying on, the Governor stated that ˝the loan from IMF will replace a part of the currency deposits borrowed from the commercial banks. I say *loan* because NBR pays the interest for a part from the liquidities of the banks.

On March, 26th, the Governor has signed a proactive financial agreement: ”In a proactive view, Romania should not wait for an economic contraction”. At the end of February, the NBR currency deposits have increased to 26 billion euros, which means a diminution of 1 billion, as last fall, when the situation of the international markets deteriorated.

Still, the currency deposits are ok. In the last years, the raise of the short term debt, has reached 22 billion euros at the end of 2008. The deposits didn’t seem so big any more. According to the external financial agreement, the funds from IMF (12,95 billion euros) will enter the currency deposit from NBR and the 5 billion euros from the European Community will help the budgetary deficit. Taking into consideration all these economic characteristics, the Governor states: ”This country doesn’t face problems with money. It’s a dangerous illusion which appeared 20 years ago. This country needs administrative and organizational abilities and a good management. The European Funds...doesn’t enter Romania because we want to, they must be absorbed. This means a fight with the birocratism and with the heavy procedures”.

Very important is his remark that NBR can only ask the banks to direct the funds from the minimum reserve towards granting credits and giving back the payments to the foreign share holders.

In the same time, NBR maintains the level of the interest to 10%, and starting May, 24 will renounce to take 40% from the long term currency reserves of the commercial banks. The banks will benefit from the 2-4 billion euros.

The generated currency will stimulate the credits and a diminution of the interest. The annalists prefer the allocation of the amounts for investments, not for consumption.

Taking this amount from the NBR accounts is a process which compensates the first installment from IMF (5 billion euros).

The Vienna agreement, signed by 9 important foreign banks with branches in Romania, stipulates that the money will go to the local banks. Granting credits is not an agreed process, because of the big interests which protect the level of the exchange rate- a stability factor of the banking system.

The budgetary system from our country is changing completely. Mr. Pogea Gheorghe, the Minister of Finances, is creating a project based on a Fiscal Council and on a law of fiscal responsability and improvement of the budget.

Another important objective is related to the external financing, capable of consolidating on a long term the fiscal policy and the financial needs. The Ministry of Finances states that the agreement with IMF and EC will support the relations with the foreign investors and will reduce the pressure on the exchange rate. The fiscal code is now a public debate.

The main taxes, VAT, flat tax and the level of contributions will remain unchanged for this year. We still have the flat rate tax. The fiscal code is under debate, and it will be applicable in 2010. The agreement with IMF contains a system of financial monitoring of the budgetary companies, in order to improve the performances or to reduce the losses.

The Ministry added that ”We will not allow new debts for budgetary companies, and they should also start reorganizing...to consolidate and improve the economic performance. In 2009 EC and IMF approve the reorganization of the public system of salaries.

The implementation will conclude by the end of the third year. The objectives of the law: the standardization of the public sector of salaries, the reorganization of the actual system of benefits. Besides the net average salary there will be also a maximum limit for other expenses, trying to maintain in the same time the real income of the employee with minimum resources.

Reorganizing the public system of pensions" will be a process which we will discuss later. The objective reaching some installments of replacing 45% from the average salary for the pension point. The fiscal consolidation and the diminution of the budgetary deficit will continue."

The budgetary deficit for 2009, agreed by IMF is 4,6% from GDP and it will be monitored when it will decrease to 531 billion euros. For 2010 it is foreseen a budgetary deficit of 3,7% from GDP, and in 2011 a 3% decrease from GDP.