EUROPEAN CRISIS' EFFECTS UPON THE ROMANIAN ECONOMY

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ABSTRACT: European Union is facing severe challenges from the financial crisis and the deep recession. The recession of the global economy affected the commercial and financial relations between European economies and between Europe and the rest of the world. European Commission has indicated how it intends to apply state aid rules to state support schemes and individual assistance for financial institutions; has provided guidance on the treatment of asset relief and impaired assets; and has presented proposals for establishing regulatory and supervisory standards for alternative investment fund managers. In this condition European Union has two major challenges: one to continue its Agenda on the integration phenomenon, and the other to apply measures to recover the crisis.

Key words: financial crisis, recession, state aid rules, state support schemes, gross domestic product

JEL codes: D24, O31.

Introduction

In the last year Europe has experienced its worst post–war recession but must continue its agenda to return to the sustainable growth objective. The European Union is facing severe challenges from the financial crisis and the deep recession. The recession of the global economy affected the commercial and financial relations between European economies and between Europe and the rest of the world. The output of the European Union's economy is expected to decrease around 4% until the end of this year. According to the European Commission Report, actions have been taken in order to stabilize financial markets and to support European Union's economy. One of the crisis' effects will result in a considerable loss of capacity in the European Union economy, adding to the pressures on long–term growth prospects that will come from population ageing, and has disrupted the progress that was being made towards achieving the objectives of the renewed Lisbon Strategy for Growth and Jobs.

This crisis presents substantial challenges for the European Union, with prompt action needed to revive financial markets and to diminish the impact of the recession on demand and employment. European Union had to provide additional financial support to some of the member states that have faced considerable economic and financial problems since the beginning of the financial crisis. The short–term challenges for the European Union are magnified by the need to press ahead with the implementation of structural reforms that will help to prevent future financial crises and correct the economic shocks in real time, improve also both longer term growth prospects and the long–term sustainability of the public finances, in the context of ageing populations.

Literature review

Financial crisis is a phenomenon that was in centre of everyone's attention all over the world, due to its impact upon the all states' economy. It is the subject of many specialists' discussions and prediction for the near or long term future and also the relations that are affecting directly or indirectly other economies. Some of these relations only now can be observed, while other observed before could be corrected through measures thought globally or adapted to each sector. Specialists from each country are analyzing the crisis' effects upon that economy and are

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trying to find solutions for surpassing the crisis from their country. Romanian economy only in 2009 could really quantify the first effects of the financial crisis. Specialists made only predictions until now regarding the Romanian economy and only now can be observed the real effects of the crisis. Still, statistical data are collected and made public by the European Statistic Institute, where are periodically analyzed data for the European Union's countries.

Research methodology

For this article I consulted the speciality literature and the recent articles and studies published on this topic. In my research, I identified first the key elements that are affecting the evolution of the Gross Domestic Product, I quantified their influence, and I tried to point out the financial crisis' effects and to show proper solutions proposed for surpassing the crisis. I collected official data from the Romanian Institute of Statistics and from European Institute of Statistics. I gathered the data regarding the contribution of main economic sectors to the Gross Domestic Product's fall and I compared the data for the first semester of 2009 with the data for the same semester of 2008.

European crisis' effects upon the Romanian economy

The European Commission has a central role in monitoring and coordinating the actions taken by member states in response to the economic crisis and ensuring they are implemented effectively. The European Economic Recovery Plan, which combined short–term measures with an acceleration of structural reforms as set out in the Lisbon strategy country specific recommendations was a welcome answer to the crisis.

Total support to demand from member states and European Union –level authorities will amount to around 5% of EU GDP in 2009 and 2010. Discretionary fiscal measures in these two years amount to a total of 1.8% of GDP, augmenting the significant stimulus coming from the relatively large automatic stabilisers in the EU. Past structural reforms and, particularly, fiscal consolidation in good times, have allowed most member states to launch fiscal stimuli in the framework of the European Economic Recovery Plan. Measures taken to underpin the financial sector and direct assistance from the Commission and other European bodies are also supporting activity. Further measures may be announced by member states that have sufficient budgetary scope. However, taking into account the contingent liabilities linked to the financial sector rescue operation and the implicit liabilities related to ageing, the fiscal space has been narrowing across the EU.

In some member states, fiscal space has been virtually exhausted owing to already high budget deficit and public debt levels, which are reflected in rising interest rate spreads on government bonds. It is vital that the Commission and the Council, through the Stability and Growth Pact, ensure that clear and credible plans for fiscal consolidation are implemented by the member states.

But, past experience shows that structural reforms that generate growth are often initiated at times of economic crisis. There is necessary prudence and attention in designing such reforms to ensure that they offer long–term benefits rather than just a short–term palliative. The European Economic Recovery Plan rightly combines short–term measures with structural reforms in order to meet the Union's medium–term objectives. In particular, it is essential that policies to support local jobs and businesses do not endanger the European single market or hamper external access to the European Economic Area. The Commission has already intervened promptly against measures that favour selected subgroups of companies and violate single market principles and must continue to do so. The Commission also needs to stand ready to ensure time–limited state aid and other fiscal supports are withdrawn promptly at the appropriate juncture as the economy recovers.

Nonetheless, the fiscal easing underway in many European economies has provided an opportunity to facilitate some worthwhile structural reforms. Well–founded investments in infrastructure, including broadband and new low–emission technologies will offer long–term supply–side and environmental benefits as well as a short–run boost to activity. The activation of labour market programmes, development and better matching skills with the market needs, reductions in social security contributions and support for low–income households will dampen the impact of the recession on labour markets and the necessary adjustments that will arise from other structural reforms. Maintaining, and even increasing, investment in education and training is a lever for helping to get through, and overcome, the challenges of the recession, thus helping to ensure that the workforce holds on to and upgrades its skills, and that people are equipped for opportunities that will arise once the crisis is over. The Commission needs to continue to monitor the effectiveness of these measures, provide guidance on policy design and facilitate the exchange of information about policy experiences.

While most financial market segments have become well integrated, financial supervision has remained predominantly national in scope. This may hinder the single market for financial services and increase the chances that financial risks related to the EU–wide activities of systemically important cross–border institutions will not be detected and acted upon. It also complicates financial crisis management and resolution, as the financial crisis has revealed. In early 2009, the de Larosière Group made proposals on how the European financial supervisory system could be improved, including: (i) measures to establish a European System Risk Council (ESRC) to oversee the stability of the financial system as a whole, and (ii) for the supervision of individual financial institutions, a European System of Financial Supervisors (ESFS), consisting of three European Supervisory Authorities (ESA), replacing the existing three Level 3 committees and working in tandem with the national financial supervisors. The ESRC would pool and analyse all information relevant for financial stability, and a macro–prudential risk warning system would be put in place. The ESFS would represent an evolutionary reform. The ESAs would have, in cases clearly specified in Community legislation, the means to ensure coherent application of Community legislation, including the power to resolve disputes between national supervisors. They would also be given the responsibility for the authorisation and supervision of certain entities with pan–European reach, such as credit rating agencies. This should better balance the interests of home and host supervisors and better take into account the EU–wide impact of cross–border activities The ESRC should make it more likely that systemic risks are quickly recognised and acted upon. In May 2009, the Commission published a Communication fleshing out the recommendations put forward by the de Larosière Group. The intention of the Commission is to present all necessary legislative proposals in the course of autumn 2009. It is essential that the proposed powers and independence of the new authorities are retained in the legislative proposals.

The Commission has announced further measures to counteract the financial crisis and has set out an ambitious agenda for financial services reform. Based on earlier roadmaps, many measures have been adopted, including a Regulation on Credit Rating Agencies and a review of the Capital Requirements Directive (CRD). Furthermore, the Commission has indicated how it intends to apply state aid rules to state support schemes and individual assistance for financial institutions; has provided guidance on the treatment of asset relief and impaired assets; and has presented proposals for establishing regulatory and supervisory standards for alternative investment fund managers. Further revisions to the CRD will be proposed in October 2009. As regulatory changes are made it will be important to remember that unnecessary or badly–designed regulation could impair the functioning of financial markets and increase instability. In the shorter term, concerns that the scale of impaired assets has not been fully recognised and that banks may be insufficiently capitalised to deal with a further deterioration in economic conditions need to be addressed.

One of the most relevant indicators of the economic situation of an economy is the Gross Domestic Product (GDP). The Gross Domestic Product estimated for the first semester of 2009 was 206451,5 million lei in current prices, decreasing – in real terms – by 7,6 percentages as against the first semester of 2008. From the viewpoint of GDP formation, we should notice the contribution to total GDP fall, of services activities, this branch holding a share of 52,1% in GDP. The gross value added in the services sector registered a fall of 5,8% and the activity volume in the construction sector was by 7,3% under the level of the first semester of 2008. The gross value added in industry registered a fall of 9,0% and agriculture, forestry and fishery decreased their activity volume by 9,5%. In the first semester of 2009, the volume of net taxes on product decreased by 11,9% as against the first semester of 2008. The analysis of factors that contributed to the 7,6% decrease of GDP points out the prevalent contribution of services (-2,9%) and industry (-2,4%).

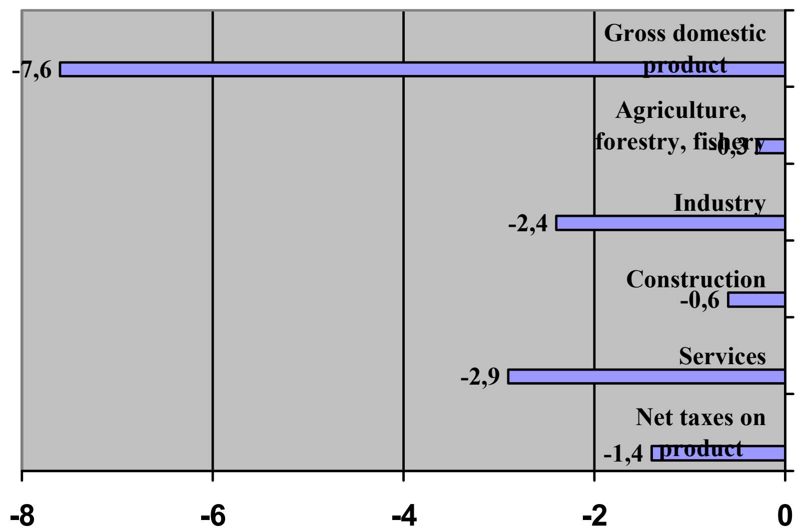

Fig. no. 1 – Contribution to the Gross Domestic product of the main economic sectors

In order to analyze the evolution in real terms of the main macroeconomic aggregates, it is necessary to deflate those using relevant price indices.

Table no. 1

Price indices of gross added value in the first semester of 2009

No.	Indicators	Value
1.	Gross Domestic Product	108,3%
2.	Agriculture, forestry and fishery	108,3%
3.	Industry	106,8%
4.	Construction	105,5%
5.	Wholesale and retail; repair of motor vehicles and household goods; hotels and restaurants; transport and communications	106,7%
6.	Financial, real estate, renting and services activities	110,8%
7.	Other service activities	110,7%
8.	Net taxes on product	111,8%

Source: Statistic Monthly Bulletin July, 2009.

The gross domestic product in current prices is calculated as the sum of its components' value in current prices. Similarly, the GDP in constant prices is calculated based on the same calculation relation, with the observation that the value of each component is estimated in constant prices using appropriate price indices. The price index of GDP is calculated as a ratio between its value in current prices and its value in constant prices and includes the effects of all the changes in prices taking place in the economy.

The evolution of gross domestic product from the viewpoint of its use points out an important decrease of domestic demand (-14,7%) and of household actual individual final consumption (-11,9%). In the first semester of 2009, the household actual individual final consumption was negatively influenced by the decrease in the volume of goods sold by retail (-18,4%) and volume of market services rendered to the population (-13,4%).

The evolution of gross fixed capital formation (-16,4%) in the first semester of 2009 was determined by the decrease of investments volume, the main component of this aggregate. Therefore, investments in new construction decreased by 3,2% and those in equipment (including transport means) registered a fall of 33,5% as against the first semester of 2008.

The decrease in exports of goods and services (-15.8%) and imports of goods and services (-29,0%), influenced the Romanian trade balance and Balance of Payments deficit. Thus, in the first semester of 2009, the Balance of Payments deficit was, in real terms, by 61,6% lower than the first semester of 2008. The analysis of factors that contributed to the 7,6% fall of gross domestic product, from the viewpoint of GDP use, points out the significant contribution of household actual individual final consumption (-9,7%) and gross fixed capital formation (-4,8%).

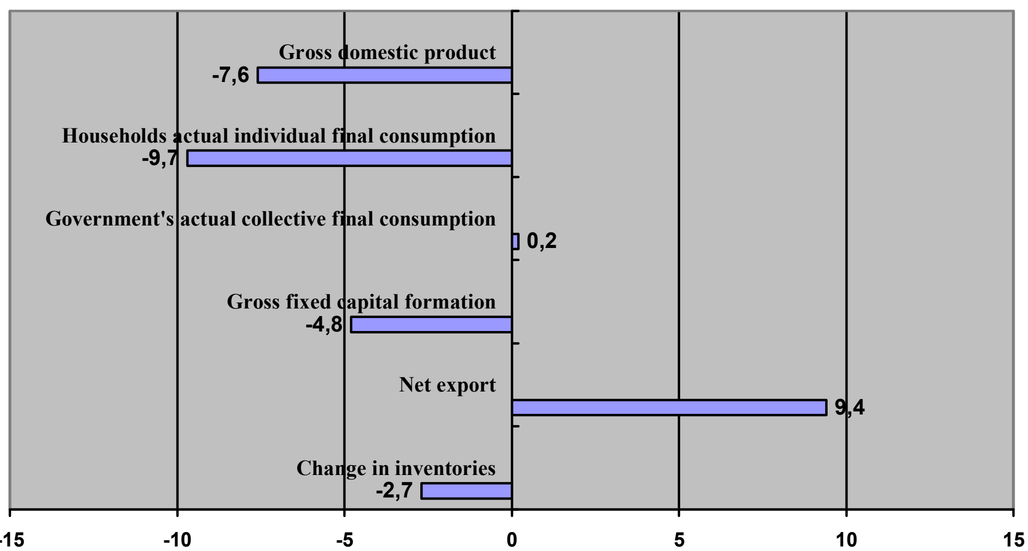

Fig. no. 2 – Contribution of the use components to the Gross Domestic Product fall rate in the first semester of 2009 against the first semester of 2008

The Gross Domestic Product – seasonally adjusted data – estimated for the second quarter of 2009 amounted to 120433,4 million lei current prices, decreasing – in real terms – by 1,1% as against the first quarter of 2009.

Activity volume diminutions have been registered in agriculture, forestry and fishery (-1,7%), trade, repair of cars and housing goods, hotels and restaurants, transport and communications (-4,4%) and construction (-11,0%).

Likewise, the volume of product taxes collected at the state budget decreased, net taxes on product registering a diminution by 3,0%.

Financial and real estate activities, renting and business services decreased by 4,1%. Industry and other service activities increased by 4,5%, respectively by 0,2%. From the viewpoint of Gross Domestic Product use, in the second quarter of 2009, actual final consumption diminished by 2,8% as compared to the first quarter of 2009, mainly due to lower expenditure for households final consumption (-3,5%). Total actual final consumption fall was vanished by 1,4% growth of individual final consumption expenditure of public administration.

Actual collective final consumption of public administrations increased by 4,4%. Gross fixed capital formation registered a significant fall by 13,5%, as compared to the first quarter of

2009. A positive effect on net export had the increase in the volume of export of goods and services (+5,0%), which exceeded that of volume of imports of goods and services (+3,1%).

Conclusions

The Gross Domestic Product estimated for the second quarter of 2009 amounted to 120433,4 million lei current prices, decreasing by 1,1% as against the first quarter of 2009. Activity volume diminutions have been registered in agriculture, forestry and fishery, trade, repair of cars and housing goods, hotels and restaurants, transport and communications and construction. Likewise, the volume of product taxes collected at the state budget decreased, net taxes on product registering a diminution by 3,0%.

The European Commission has announced further measures to counteract the financial crisis and has set out an ambitious agenda for financial services reform at the European Union's level, measures that have to be implemented in all countries' economies and help them to recover. Based on earlier roadmaps, many measures have been adopted, including a Regulation on Credit Rating Agencies and a review of the Capital Requirements Directive. Furthermore, the Commission has indicated how it intends to apply state aid rules to state support schemes and individual assistance for financial institutions; has provided guidance on the treatment of asset relief and impaired assets; and has presented proposals for establishing regulatory and supervisory standards for alternative investment fund managers. Further revisions of the Capital Requirements Directive will be proposed at the end of 2009.

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