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SOME ASPECTS REGARDING THE PREDICTABILITY OR NON-PREDICTABILITY OF THE GREAT DEPRESSION. CASE OF ROMANIA

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Abstract:
Analysis of the crisis, particularly financial ones, the generating factors and the applicable patterns to return to normality is a consistent and timely concern of researchers in economics. After the advent of the global crisis in mid-2007, many researchers recognized internationally and nationally formulated theories about the causes, effects and intensity of the current crisis, providing reference works in the field.

The starting point of the research puts in the spotlight the fact that the deepest crises have their "origins" in developed countries, but are funded by the emerging countries. In the context of this "reality" the economy seeks to predict the possible behaviours in configuration of a context to return to normality, where unexpected trends and consequences of unintended effects require completion of the theory deficit in Romanian economic literature regarding the economic effects caused by subjective decision, especially political decisions.

Carrying out research with a high degree of completeness, necessarily requires knowledge and understanding of the history of financial crises, starting with the Great Depression, focusing on the implications on the Romanian economy, and in particular, on the intervention models commonly used in order to identify "optimal model" that allows escalation of the current crisis, but also a more accurate predictability of future adverse events.

Key words: financial crisis, economic crisis, economic growth, banking, globalization

JEL classification: F61, F62, G01, O10

THE GLOBAL ECONOMY AND THE GREAT RECESSION OF 2007

Since the beginning of the current crisis, theorists, economists, but also major economic actors and governments have sought to identify similarities with the Great Depression in the years 1929-1933, and with the crisis that followed the Second World War. There are also many questions about the ability of models and quantitative analysis to signalise or not the onset of such a deep crisis.

On September 7, 2006, being present at a conference organized by the International Monetary Fund in Washington DC, Nouriel Roubini issued a warning hard to be accepted at that moment by the U.S. economy: "*the nation's economy will soon suffer a dramatic fall, that you only assist once in a lifetime, of the housing market; a brutal shock oil; a steep decline in consumer confidence and, inevitably, a deep recession*". The end of that speech was quite clear "*housing market collapse could lead to a systematic problem for the financial system*", and unfortunately only a few months after this warning the events precipitated, and this scenario has become a cruel reality.

It is widely accepted that the Great Recession that began in 2007, which had its epicentre in the U.S. was caused by speculative bubbles in the housing market due to unprecedented growth and no correlation with price reality on the housing. But this was not the only trigger, we can talk about a number of factors, namely: trade record deficit and current account deficit, which attracted cheap foreign capital inflows and permissive regulatory policy. Profound effects manifested on financial markets and also at the level of global economy emphasize that we are dealing with "*the most serious global financial crisis since the Great Depression*" (*Reinhart and Rogoff*, 2009).

We can question whether, at least in the year 2006, we could identify some signals that could attract attention to the event triggering the crisis. Reactions in the period before the crisis can be grouped into two categories: alarmist reactions (those that predicted the occurrence of events leading to a crisis), and refusal reactions in which regards the possibility of crisis to started.

Refusal reactions	*Alarmist reactions*
Dooley, Folkerts-Landau and Garber from Deutsche Bank (2004): „[…] U.S. current account deficit is only a natural consequence of the emerging states efforts to engage in export-based economic growth and their need to diversify investments in safe assets.”	*Obsfeld and Rogoff* (2005): „[…] c The U.S. current account was unsustainable oversized.”
Ben Bernanke (2005), referring to the over-indebtedness of USA: „[…] Middle East countries are looking for ways to use their earnings from oil, and countries with underdeveloped systems as China, are seeking to diversify their investment portfolio with safer assets. The low rates of return on investment from the rest of the world simply make our country to be particularly attractive for investment.”	*Roubini and Setser* (2005) „[…] U.S. loan problem will worsen even more, reaching 10% of GDP before the dramatic collapse.”
Alan Greenspan (2006) „[…] the growing deficit (of the U.S.A) reached over 6.5% of GDP in 2006, is merely a reflection of the more general trend towards global financial development, which allows countries to sustain current account deficits and surpluses more higher than in the past.”	*Paul Krugman* (2007) „[…] will inevitably occur a *Wile E. Coyote* moment when the unsustainability of the U.S. current account will become clear as day to everyone, and the dollar will fall sharply.”

If we review the events that occurred after the Second World War, I think the situation would become slightly clearer especially in terms of forecasting ability or non-predictability of the current financial and economic crisis. The period after the Second World War was characterized by a multitude of turbulence situations that have caused systemic crisis: the first oil shock of the mid-1970s has been accompanied by episodes of severe inflation; the banking crisis in Spain 1977; recessions caused by measures to combat inflation that occurred in the early 1980s; banking crises in the Nordic countries (Norway in 1987, Sweden and Finland in 1991) and the crisis in Japan in the early 1990s (lost decade); exchange crisis called "Black Monday" of 19 October 1987, when stock markets around the world have lost large sums of money (e.g. Hong Kong stock exchange recorded a loss of 45.8% of its value, market London has lost 26.4%, while the New Zealand stock exchange recorded a loss of 60%) dot-com crisis in 2001.

Each of these crises have affected equally both developed and emerging countries, however some authors believe that after the mid-1980s the world economy was characterized by a "decline in macroeconomic volatility" (McConnell and Perez-Quiros, 2000; Blanchard and Giavazzi, 2001). But would things have been like?

The debt crisis of the 1980s that manifested as tough as the Great Depression of the 1930s, affected the Asia, Africa, Latin America and some countries in Eastern Europe (the former Soviet Union and Romania) and culminated with the insolvency of Argentina from 2001-2002. Therefore, I consider that period between the early 1980s and until 2003 was characterized by a high degree of macroeconomic volatility.

The period 2003 - 2007 was characterized by global economic growth, the increase in the price of goods due to lower interest rates, lower unemployment, and these positive developments have led many scholars to believe that the global economy has entered an uptrend. However, although the "positive aspects" are undeniable, my first warning sign that comes to contradict the optimism of that period appeared in September 2001, when the United States suffered the worst terrorist attack in history. I think that was the start of the global economic decline that culminated in September 2007 with the outbreak of the current crisis.

Referring to how a crisis is signalled, Reinhart and Rogoff (2009) consider that the majority of attacks that hit the global economy after the Second World War have two basic elements in common: on the one hand, raising venture capital to counter current account deficit, on the other hand unprecedented growth of real estate prices. Therefore, where these two elements are emerging, it is necessary to adopt measures to limit their adverse impact. Also, as Reinhart and Rogoff (2009) but also Krugman (2007) and Minsky (2008) argue that liberalization and poor regulation played a major role in triggering the global financial crisis.

We must not lose sight of the fact that liquidity shortages cause problems for the banking system, in particular, and the reduction of cash flow is the initial stage for the emergence of a crisis. In this situation, banks are forced to put up for sale assets, causing a domino effect that leads to lower the bank's assets and ultimately to the crisis of solvency (Lybeck, 2011). Referring to the instability that can be caused by the banking system, Keynes (1936) stated that "*the alarm associated with the rapid growth of debt is the fragility of many of our financial institutions*." Also Keynes is one that draws attention to the economic boom that we associate with "optimistic expectations of future yield of capital-assets ratio," but he further states that "when disillusionment is installed in a too optimistic market with excess demand” the market collapse is imminent.

Another way to estimate the crisis is highlighted by Minsky (2008). He states that "financial panic is possible because of changes in financial structure that occur during the long expansion of optimism." Typically, during periods of economic expansion, both investors and financial institutions consider that they are safe and will focus on investments with high risk and most relevant example of this is the large number of securitized products traded in the period before the crisis in 2007, which led to the development of a "shadow banking system". Also, Minsky believes that the gap between the financial economy and the real economy will lead to future instability. In this respect, the most relevant examples are Ireland, Iceland, the UK and U.S.A, where oversized financial components of the economy is evident in relation to the real economy (Lybeck, 2011).

The empirical analysis conducted so far allows synthesizing crisis warning signals (Lybeck, 2011):

- unrealistic increase in the value of assets, shares and house prices;
- current account growth deficit;
- lowering the household savings;
- increasing indebtedness;
- large volume of short-term loans of corporations, banks and households;
- investing with a high degree of risk;
- excessive liberalization of the capital market and its poor regulation.

KEYNES’S INTERVENTIONISM VS. SCHUMPETER'S CREATIVE DESTRUCTION

The devastating effects of the financial crisis require the implementation of recovery measures which have to be more easy to apply by all governments of the affected countries, and the results of these measures should focus primarily on economic growth, financial stability, decreasing unemployment, and diminishing and stabilization of government debts, in a word, going beyond the highest rate of growth.

Measures to overcome the crisis are addressed differently from country to country and in the USA, but also most representatives of the G20 agreed that the measures J.K. Keynes found to be optimal for the Great Depression of the 1930s are to be applied to the current crisis. Thus, Keynes argued that the deficit should be increased to stimulate the economy, i.e. states must intervene to make the economic system work, but the intervention must be limited meaning that "will leave untouched the private property and the right to make decisions" (Krugman, 2008).

State intervention in the economy, advocated by Keynes, was also criticized by proponents of the Austrian School who believe that economic interventionism, implementation of some loose monetary policies and the regulation will generate disturbances in the effective functioning of the free market. An important representative of this school of thought is Joseph Schumpeter and the theory of "creative destruction" that he developed is considered a more viable alternative to escalating financial and economic crisis. According to this theory, times of crisis and recession caused by this crisis is "the process of industrial mutation which revolutionizes the economic structure from inside" after which will survive the economic agents that have a high capacity for innovation and succeed in creating a new economic order (Schumpeter, 2006).

Keynes' interventionist effects are concretized in fixing of prices for the capital assets and for the special economic properties of financial institutions capitalist economy. The focus is on performance capitalist system which emphasizes investment, the way in which investments are funded and the effects of financial commitments. The author points out that the market mechanism is not necessarily a system capable of self-regulation which pursues and sustains for itself the full employment of labour, therefore capitalism is a system that occasionally unbalances, but can be stabilized by state intervention. (Keynes, 1936)

Contrary to these arguments Schumpeter believes that the state should not intervene in the economy even when it is facing a situation of crisis because instability is the consequence of innovation, and this is the essence of capitalism. Therefore both businesses and nonperforming financial institutions should be left to self-destruct so that in the end only the strong to hold (Schumpeter, 2006).

I appreciate that the effects of "creative destruction" can be harmful to the global economy, particular in the situation of devastating crisis, as the current one, if we consider interconnections that actually enable the economy to function as a whole.

Considering sustainable the Keynes's approach regarding to measures to stimulate the economy, Stiglitz (2010) consider that a well-found incentive scheme is based on the following principles:

a) must be fast, i.e. it is absolutely necessary the supply of money in the economy;

b) must be effective, in the sense that each monetary unit spent should generate increased employment and production growth;

c) must address long-term problems of the country, which means that an effective system of measures to consider raising national saving, reduction of trade deficits, rehabilitation and development of infrastructure, provision of long-term financial programs for social assistance, etc.;

d) must concentrate on investments: investments are envisaged investments in assets that lead to long-term productivity of the country, which will positively affect the standard of living;

e) must be equitable, i.e. do not undertake measures that will be advantageous only for certain category of the population (this refers to the top class of society);

f) must deal with pressing short-term needs that would be created by crisis in the sense that a well-designed set of measures should assist countries which, due to the lack of money, they cut jobs;

g) stimulation should be directed to areas where there are layoffs in the sense of allocating financial resources to personnel retraining.

SOLUTIONS FOR ROMANIA: LIMITED INTERVENTIONISM OR DISRUPTIVE ACTION

The effects of financial crisis triggered in 2007, which had its epicentre in the United States still has adverse effects on the economy of our country. I will address solutions which Romania has implemented and will implement them to climb out of the recession through a comparative study between the Great Depression of the 1930s and the Great Recession that we face This approach was taken also by Reinhart and Rogoff (2009), and the authors believe that there are similarities between the two crises, first of all because it had the same trigger point location (USA) but also by the fact that in both cases we are dealing with the increase in government debt in affected countries, as well as with a high volatility in asset prices Certainly, the current crisis differs from the Great Depression by the fact that due to financial globalization, technological change and information technology spillovers are much faster and recovery measures are more diversified. Financial innovations and poor regulation and supervision of financial institutions are distinct elements that differentiate the current crisis.

It is generally accepted that programs of severe cost reduction and increase taxes as well as growing in rates of interest lead to reduction of economic activity, also causing decreasing of budget revenues The austerity measures that the Romanian government has taken in May 2010 such as cutting wages, social insurances and pensions, are consistent with those the executive in the period 1930-1933 has considered optimal for reducing the government expenditures are known as "curves of sacrifice".

On the other hand, we can identify as being of nature of "limited interventionism" the measures Romanian government envisaged, and these measures are consistent with measures taken at EU level, namely:

1. the ratification of Fiscal Stability Treaty which provides common budgetary rules entitling control over national budgets to the European Commission. Treaty establishes as threshold limit for structural budget deficit up to 0.5% of GDP, which implies maintaining public debt below 60% of GDP. The "Golden rule" of the treaty refers to the fact that the budgetary deficit plus the structural one will be within the limit of 3% of GDP. Failure to comply with these terms will trigger an automatic correction mechanism which shall be provided in national law. Therefore, the aim of this treaty is to strengthen the fiscal discipline.

2. the establishment of the Financial Supervisory Authority (FSA) which merges the National Securities Commission (NSC), the Insurance Supervisory Commission (ISC) and the Commission for the Supervision of the Private Pension System (CSPPS) and is responsible for the prudential supervision of the capital market, insurance sector and system of private pensions funding.

A highly debated and analysed issue regarding measures and solutions to revive the economy, is the financial stability and economic growth. Analysing this issue Krugman says that "you cannot have prosperity without a functioning financial system but financial system not necessarily leads to prosperity." Also, NRB governor Mugur Isărescu pays particular attention to financial stability, but it is an interesting approach that he had it before the crisis, and then, after its effects have been felt plentiful in the Romanian economy

Before the crisis	After the crisis
The main source of financial instability is inflation therefore the condition "(almost) sufficient" to promote financial stability is to ensure price stability.	The global financial crisis that broke out in 2007, in the conditions of an economic environment characterized by low inflation, shows that price stability does not guarantee financial stability.
To simplify the design and implementation of monetary policy and to avoid conflicts at the level of proposed objectives it is necessary the clear separation of function of price stability assurance from function of financial stability assurance.	Mitigating the consequences of the financial crisis is proving much more expensive than authorities' intervention to limit or correcting imbalances in an early stage of their manifestation.
Markets always have the ability to self-regulate and therefore it is not required extensive intervention in the financial markets from the monetary authorities.	"The costs associated with distortions a relatively high level of inflation generates may be less important than the losses caused by distortions in the financial sector" (Stiglitz 2010)

Therefore, the crisis revealed on the one hand, that globalization involves a high degree of difficulty to macroeconomic governance; on the other hand, the relationship between financial system and the unpredictable effects of external events is a major obstacle to the implementation of internal policies.

CONCLUSIONS

In 2011 the negative effects of the financial crisis triggered in 2007 have increased as a result of the sovereign debt crisis of the old continent countries. Most European Union member states, except Germany, have faced and unfortunately continue to face with low rates of economic growth, and this period of instability caused a reduction in living standards for the entire society. At the same time, increased economic difficulties faced both by the United States and by the European Union are signals showing that the Western powers have reached a critical point that will have systemic effects in the new global economic order.

As a result of economic indicators impairment in Western countries, we can identify the signals of global order rearrangement which are given by the rise emerging economies and the possible effects of consolidation of political and economic alliances mainly "South-South". Thus, recognition the necessity for collaboration with representatives of emerging countries in order to find solutions to the problems mankind is facing with since the crisis triggered in 2007 was the formation of G20 group, when foundations of new global governance were established. Due to this decision, the participants in G20 debates represents 90% of global GDP, two thirds of the world population and 80% of world trade (Stiglitz, 2010).

Analysis undertaken in the last part of this paper highlights the fact that Romania, like other countries, has been and still is affected by the financial crisis of 2008. With regard to measures escalating recession that our country faces, we find that they can be considered as consistent with the measures taken by other European countries.

It is generally accepted that programs of severe cost reduction and increase taxes as well as growing in rates of interest lead to reduction of economic activity, also causing decreasing of budget revenues The austerity measures that the Romanian government has taken in May 2010 such as cutting wages, social insurances and pensions, are consistent with those the executive in the period 1930-1933 has considered optimal for reducing the government expenditures are known as "curves of sacrifice". However, all these measures have not generated the expected economic growth and, unfortunately, increasing unemployment, especially among young people, along with falling industrial production, facts that entitle me to appreciate that the Schumpeter's "creative destruction" was the choice for our country, although none of the domestic industries make their presence felt through creative innovation.

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