LOOKING BEYOND THE CRISIS.
LESSONS FROM THE EUROPEAN ECONOMIC DECLINE

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Abstract: *This paper gives an overview on the deepest EU's recession since the 1930s. The purpose of this study is to analyze the main macroeconomic indicators and their domino effect, in times of crisis. The abrupt downturn of the EU economy wasn't entirely an unpredicted event. This is why the impact of the macroeconomic instability should never be underestimated in the future. Prevention, control and resolution represent elementary lessons from the way the current economic crisis has been handled. The analysis, added to the disruptions caused by the economic crisis, shows that the recession continues to weigh on the perspectives and solutions of the macroeconomic stability.*

Keywords: economic and financial crisis; European Union; perspectives; solutions

INTRODUCTION

The present economic problems of the European Union have deeps roots. The déjà-vu feeling of 2008 has emphasized the various similarities between the present crisis and what had happened in '29 - '33. The following pages describe the decentralized decisions that have led to the failed politics and rushed the present economic-financial crisis, and the lessons that can be learned. The wrong decisions have not only resulted in the crisis, but have exacerbated its deepness and duration, leaving behind week economies and mountains of debts.

The excessive assumption of risks, the conflicts of interests and the generalization of the corrupted and dishonest behavior – all these manifestations have resurfaced each time the bloom periods have been transformed into collapses, and the present crisis is not an exception.

This article describes how flawed perspectives led to the current economic crisis, how did they determine the main decision factors in the private and public sector to refer with great difficulty the problems behind the appearances and how they contributed to the failure of institutions in managing the repercussions effectively.

This paper focuses on the institutional framework, that by means of the decisions and agreements concluded, plays a key role in risk reduction, first by promoting transparency, and then by strict applying regulations. The article follows an arc over time dwelling on the deep roots of the recent crisis and the ways in

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which the decline occurred after a very predictable pattern, conforming to the extremely old precedents.

1. LITERATURE REVIEW

The economic theories of the last century came with a great contribution of ideas regarding the causes that determine the markets to often fail and what can be done to help them work better. Economists have chosen to ignore the progress of knowledge. They chose to claim that Adam Smith and Friedrich Hayek had the final word in terms of market efficiency, but have not heeded the warnings of these scientists in regard of the need for state intervention.

According to Austrian economist Schumpeter, each market is temporarily dominated by a monopolist, but which gets to be pushed aside by another innovator who, in turn, becomes the new monopolist (Schumpeter, 2010). Participants compete among themselves for markets rather than within markets, and that competition is made through innovation. Recent experience shows that things may not be as good as the market supporters describe it.

Hayek, like Schumpeter, departed from the equilibrium theory dominating standard economics. He wrote his work in the middle of the controversy arisen by communism - where the state assumes the dominant role in managing the economy. In these systems, decision-making is centralized within a ministry of planning. Some of those who had passed through the Great Depression and had seen massive poor resource allocation believed that the state should take the lead in determining the allocation of resources. Hayek challenged these views, arguing not only informational advantage of a decentralized system of pricing, but also on a more general level, the development of decentralized institutions (Hayek, 2006).

Darwin talks about survival of the most adaptable body and social Darwinism has advanced an argument that the ruthless competition in which only the most adaptable companies, is one that would lead to permanent efficiency of the economy (Darwin, 1967). Unfortunately, natural selection does not necessarily select those institutions that are also the best ones in the long term. One of the key critics brought to the financial markets, refers to the fact that they have become more myopic. Some institutional changes have made it harder for companies to adopt long-term perspective. In the current crisis, some companies complained that they would not, in fact, want to be indebted, but if they didn't, they would not have survived. These institutions have not found another solution than to follow the herd, with disastrous effects in the long term.

Karl Marx thought the crisis is an integral part of capitalism, and that it is a sign of its imminent and inevitable collapse. Marx saw capitalism as inherent, unstable and prone to crisis. In his view, capitalism is the embodied chaos that will inevitably plunge into the abyss, taking with him the economy. Capitalism, according to Marx, is doomed (Marx, 2009). So far, history has not given him justice.

The words of John Maynard Keynes in "The Great Slump of 1930" could have been written today: "natural resources and human ingenuity are equally fertile and fruitful as they were before. But today we've got a huge mess, making a mull of controlling a machine whose operation we do not understand. The result is that our possibilities of wealth may be scattered in the wind for a while, maybe for a long time" (Keynes, 1930 p 136). Now, as then, we live after an economic catastrophe. Keynes has provided us with much of the analytical framework needed to give rational point depressions.

Economist Hyman Minsky has dedicated his entire life building a theoretical edifice on the foundations set by Keynes. Minsky argues that, by its very nature, the instability is an inherent and an inescapable drawback of capitalism. According to Minsky instability is rooted in the very financial institutions that make capitalism possible (Minsky, 2011).

In order not to repeat the Great Depression, economist Irving Fisher thought that a central bank must intervene and assume the role of a lender of last resort, providing needed funding to the institutions, and even for corporations and individuals. In extreme cases, Fisher argued that the government should revive the economy by flooding it with easily obtained money (Fisher, 2011). This occurred in current times as well. With the deepening crisis, governments have turned to the teachings of the Great Depression and proceeded accordingly.

Joseph Stiglitz roughly criticizes financial institutions, decisions and agreements concluded by them in recent years, ironically inviting those who want adrenaline, those who want to pay money in horse racing and casinos in Las Vegas (Stiglitz, 2010). Too many bankers have forgotten that responsible citizens must be accompanied by a moral conscience. But they have hunted and taken advantage of the poor and most vulnerable. The greed that has gripped the economy has been exploited the most vulnerable in society.

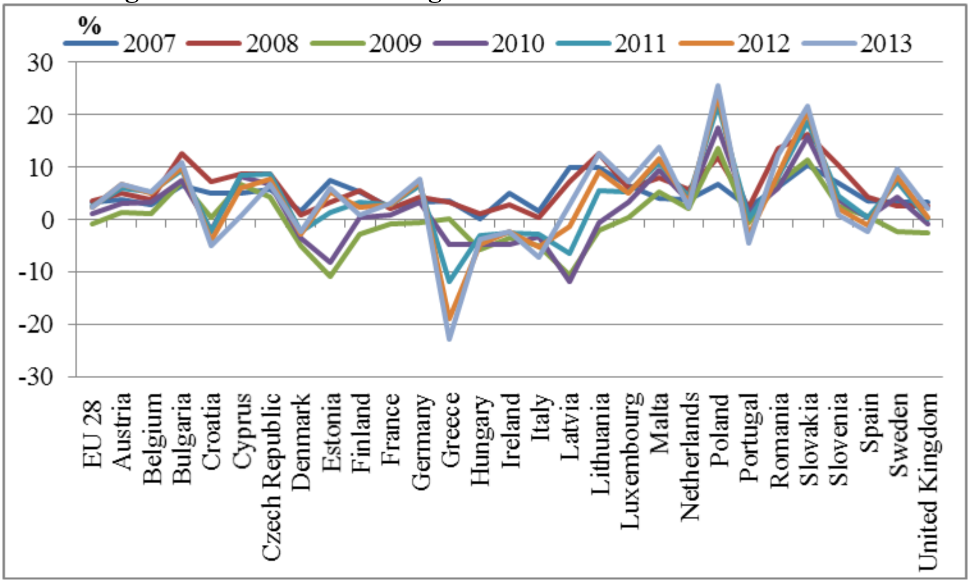
According to economists Reinhart and Rogoff, the history’s lesson is that, even when the institutions and decision factors improve their performance, the temptation to exceed the limits will always exist (Reinhart and Rogoff, 2010). Just as a man can become poor, however rich he may be at first, an economic system can collapse under the pressure of greed, political games and the desire to profit, no matter how well regulated it may seem to be.

2. THE CURRENT CRISIS AND THE DOMINO EFFECT OF THE EUROPEAN ECONOMY

The current financial and economic crisis has put Europe under the shock of turbulences. Alongside the EU vulnerabilities, the crisis came too soon. It came, in fact, before the European Union concluded monetary and fiscal consolidation processes, and before having taken measures to strengthen economic and financial immunity.

Macroeconomic indicators analyzed below illustrate how Europe was affected by the current economic abruptness: declining economic growth, with public debt, inflation and unemployment rising in unison.

Figure 1 – EU's real GDP growth rate between 2007 and 2013



Source: processed after the data from Eurostat

The most powerful economic decline belongs to 2009, moment in which in the Baltic States (Estonia, Latvia and Lithuania) the evolution of the Gross Domestic Product registered values of -14% and -17%. The economic instability was also significantly enhanced in Croatia, Finland and Hungary. The economic trend rebounded by 2012, the next period being characterized, again, by a small destabilization of the European economy.

At the group level, European countries that now face fiscal difficulty began to significantly improve the position of the debtor, until the crisis is triggered. Along with the crisis, Europe's debt began to grow vertiginously.

Table 1 – European Union's general government gross debt in times of crisis

	2007	2008	2009	2010	2011	2012	2013
EU (28 countries)	:	:	74.3	79.9	82.4	85.2	87.1
Austria	60.2	63.8	69.2	72.5	73.1	74.4	74.5
Belgium	84	89.2	96.6	96.6	99.2	101.1	101.5
Bulgaria	17.2	13.7	14.6	16.2	16.3	18.4	18.9
Croatia	:	:	36.6	45	52	55.9	67.1
Cyprus	58.8	48.9	58.5	61.3	71.5	86.6	111.7
Czech Republic	27.9	28.7	34.6	38.4	41.4	46.2	46
Denmark	27.1	33.4	40.7	42.8	46.4	45.4	44.5
Estonia	3.7	4.5	7.1	6.7	6.1	9.8	10
Finland	35.2	33.9	43.5	48.8	49.3	53.6	57
France	64.2	68.2	79.2	82.7	86.2	90.6	93.5

	2007	2008	2009	2010	2011	2012	2013
Germany	65.2	66.8	74.6	82.5	80	81	78.4
Greece	107.4	112.9	129.7	148.3	170.3	157.2	175.1
Hungary	67	73	79.8	82.2	82.1	79.8	79.2
Ireland	24.9	44.2	64.4	91.2	104.1	117.4	123.7
Italy	103.3	106.1	116.4	119.3	120.7	127	132.6
Latvia	9	19.8	36.9	44.5	42	40.8	38.1
Lithuania	16.8	15.5	29.3	37.8	38.3	40.5	39.4
Luxembourg	6.7	14.4	15.5	19.5	18.7	21.7	23.1
Malta	60.7	60.9	66.5	66	68.8	70.8	73
Netherlands	45.3	58.5	60.8	63.4	65.7	71.3	73.5
Poland	45	47.1	50.9	54.9	56.2	55.6	57
Portugal	68.4	71.7	83.7	94	108.2	124.1	129
Romania	12.8	13.4	23.6	30.5	34.7	38	38.4
Slovakia	29.6	27.9	35.6	41	43.6	52.7	55.4
Slovenia	23.1	22	35.2	38.7	47.1	54.4	71.7
Spain	36.3	40.2	54	61.7	70.5	86	93.9
Sweden	40.2	38.8	42.6	39.4	38.6	38.3	40.6
United Kingdom	43.7	51.9	67.1	78.4	84.3	89.1	90.6

: = not available

Source: processed after the data from Eurostat

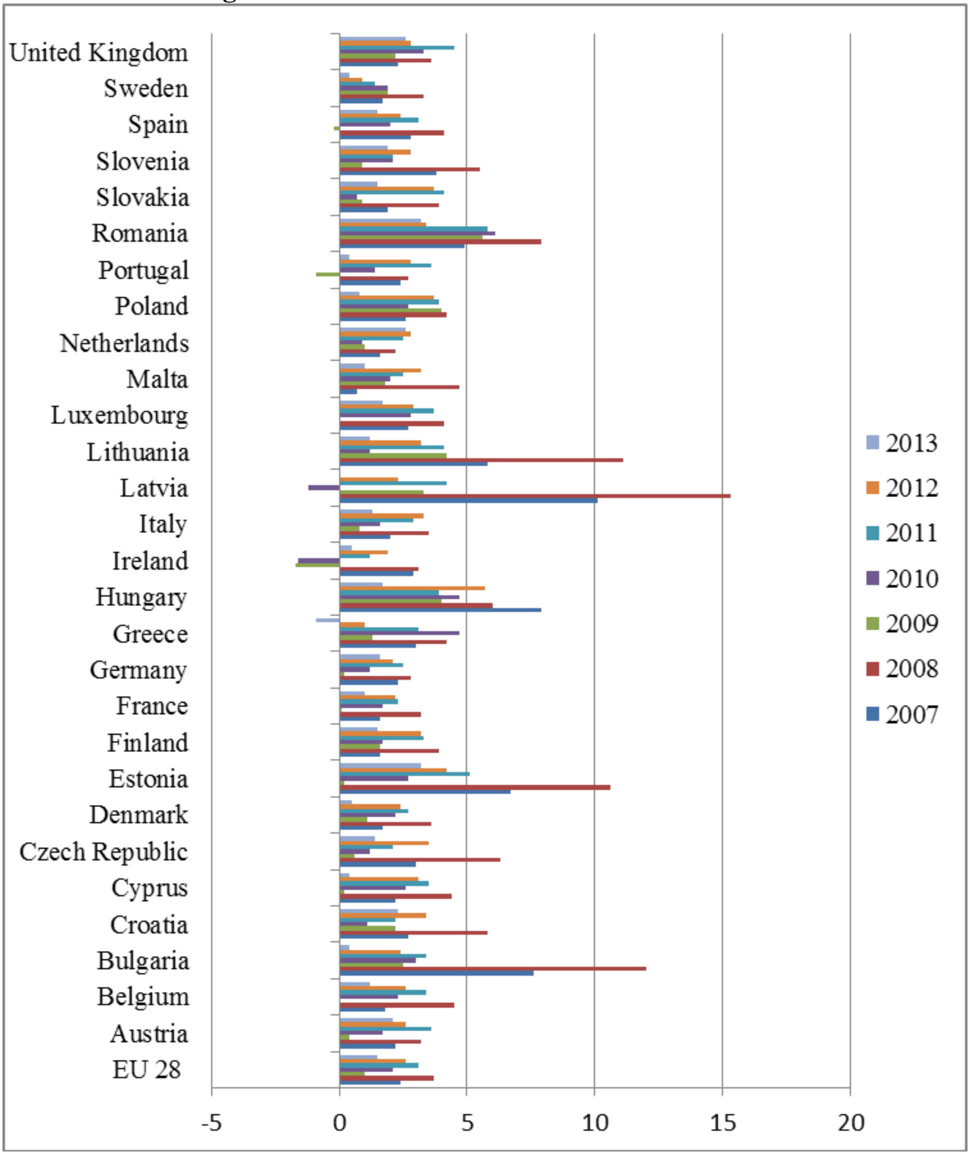
The vast majority of countries which have adopted harsh austerity policies, despite high unemployment rate, did forcibly compelled creditors. Greece, Ireland, Italy, Spain and Portugal found themselves unable to overcome debts and were forced to drastically reduce their expenses and increase their taxes. But there was one exception - a government willingly engaged in austerity, that is, the British government.

The data presented in Table no. 1 delineating well the PIIGS countries (Portugal, Ireland, Italy, Greece and Spain) from the rest of the European countries. Although it creates problems, the public debt levels are not the causes of the crisis in the PIIGS countries. For these countries, the main problem that led to the crisis outbreak is the current account imbalances of the private sector. External imbalances of private sectors in these countries have been exacerbated by the adoption of the euro, which made them more dependent on unit costs with the manpower, i.e. the ratio of nominal wages and labor productivity. The hypotheses that the productivity trends in the euro area countries will converge, are not true, so that the different growth rates of nominal wages have emphasized the trade balances disequilibrium.

Loss of competitiveness on the route of relatively rapid growth of nominal unitary labor costs in Italy, Greece, Portugal, Spain and Ireland was exacerbated by the appreciation of the euro. The appreciation statement was a factor that worked to erode the average competitiveness of the euro area and pressured for the deterioration of current account deficits throughout the euro area. In the south, the appreciation was combined with the lack of real convergence, making it the main source of competitiveness deterioration of the crisis in the European Union.

The competitiveness evolution of the PIIGS countries after joining the euro area shows that countries that have joined the monetary union with a low competitiveness could not converge sustainably to all productivity levels of countries in the North. The crisis has shown that the single currency is not enough to make productivity trends converge. Due to massive borrowing in euro, they cannot allow the euro to become competitive enough without bearing huge costs for them.

Figure 2 – EU's inflation rate in times of crisis



Source: processed after the data from Eurostat

Hence, an important lesson for aspiring to the single currency: since the productivity convergence hypothesis was not confirmed within the area, the entrance in the money area should be delayed until labor productivity will converge sufficiently with that of the north - however long the process will be. Insufficient training would result in a crisis, as was the case with PIIGS countries. However, maintaining a relatively close date to accede to the euro area is relatively beneficial, as it can lead to the acceleration of reforms needed to reduce disparities in productivity.

Figure no. 2 shows the inflation rate in the EU area, in the context of the current financial and economic crisis. Compared to the EU average, the largest known monetary slippages are in Bulgaria, Estonia, Latvia, Lithuania, Romania and Hungary. In the opposite corner there are Austria, Belgium, France, Germany and the Netherlands.

Regarding the decreasing degree of labor employment, Cyprus, Croatia, Greece, Ireland, Italy, Slovakia and Spain are in the top of the classification, with values exceeding even 26% in the case of the Iberian Peninsula, or 27% in the Hellenic State. The lowest levels of unemployment were maintained, during the crisis, by Austria, Germany, Luxembourg and the Netherlands.

We conclude that, from a technical perspective, we escaped the recession, but the economic recovery could be moderate. The above data show that the economy generally recovers at low levels, but the EU needs new reforms, deficit reduction and a new innovation stake.

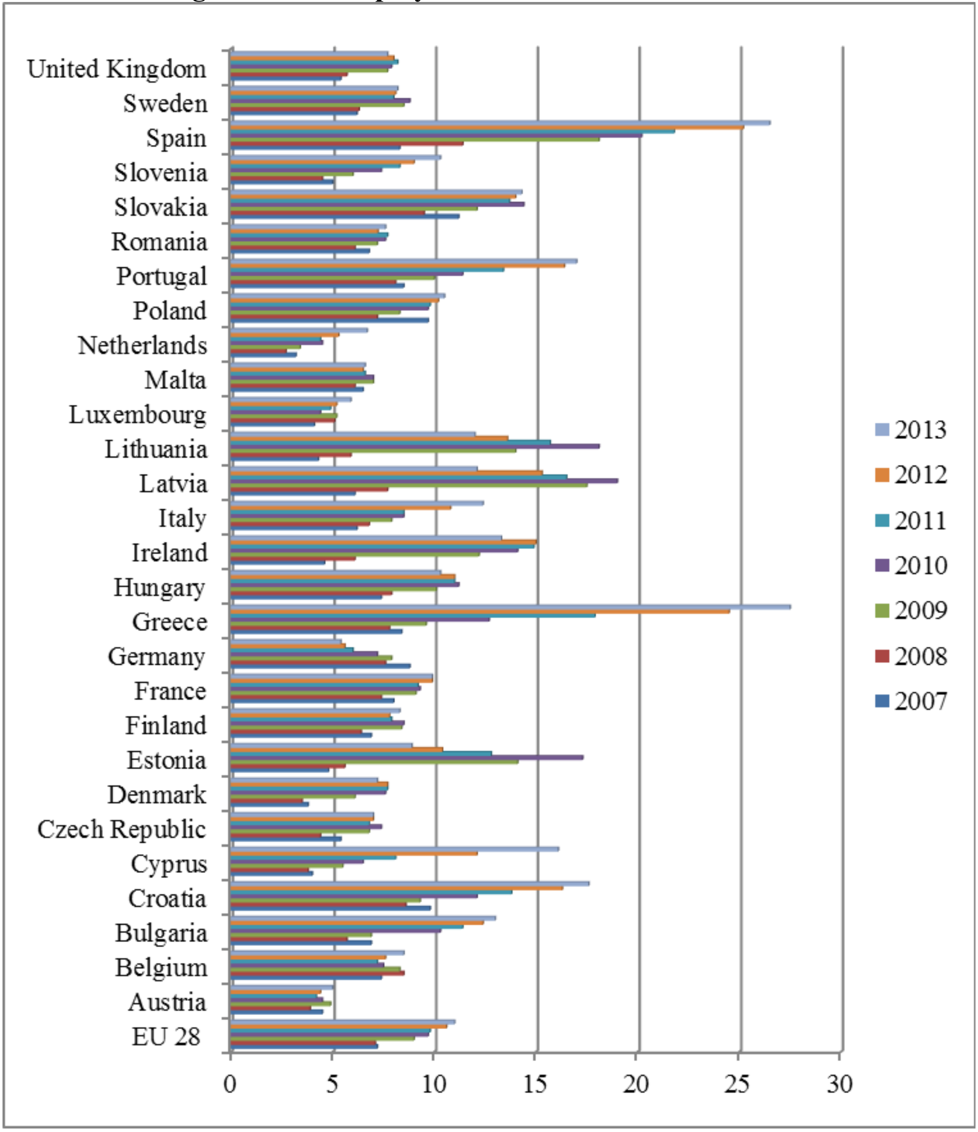
3. LESSONS OF THE EUROPEAN ECONOMIC DECLINE

People forget quickly and apply little of what they learned, often within the same generation. The current economic crisis exported from the United States has quickly studded Europe. Stock market crashes, contractions of credit, extended declines in the housing market and inventory adjustments had taken place, but after the Great Depression they were no longer so crowded, fueling strength as they advanced. There was a common basis: the folly with which the financial department had given loans, fueling the housing bubble that eventually burst. The collapse of the speculative bubble and credit contraction had inevitable consequences.

Mankind has traversed thus one of the most serious and dangerous economic crisis in its modern history, the crisis will undoubtedly generate a number of important changes socially and politically, ample movements in the power balance globally. The consequences of these decentralized decisions will force us to reevaluate how we think about the economy, how we relate to it, the processes that determine it, to the state and to the market, to democracy as a political system.

An important characteristic of the decentralized decisions is the lack of transparency. Every time there is a crisis, it becomes obvious that there was a lack of information. The issue of transparency in fact refers to the problem of deception. Institutions were actively engaged in deceptive practices and conventions. Transparency, in order to have any type of usefulness, must be total. If some channels are allowed to remain in obscurity, all decisions and illegal activities will go there. As the recent years revealed, financial institutions do not like transparency. A fully transparent market would be extremely competitive and under intense competitive conditions, fees and profits would be pulled down.

Figure 3 – Unemployment rate in the EU's countries



Source: processed after the data from Eurostat

Peeling the onion of the current economic crisis, there emerges a poor corporate governance, inadequate law enforcement, imperfect information and inadequate knowledge of risks from investors. In the period after the last big boom, which led to the Great Depression, governments have tried to attack this problem by setting up new regulatory structures, but attempts were short-lived.

Institutions charged with maintaining the stability of the economic system failed to prevent the crisis and did not have the necessary capacity to organize the required coordinated response. The incoherence of the International Monetary Fund's (IMF) decisions has been repeatedly criticized. In the past, the IMF has provided funds, but only under the conditions of respecting some harsh clauses that actually aggravated the economic situation of the countries that were hit the hardest. The strict conditions imposed by the IMF have led to riots all over the world. In the present context, the IMF finally recognized the need for Keynesian macro-stimulation policies. However, although in many countries the IMF programs were much different from those in the past, it seems that for some of them, they continued to be applied harsh - including budget cuts and high interest rates, the exact opposite of what the Keynesian economic theory recommended.

Recent financial rescue operations are the exemplification of a set of coherent decisions that may have long-term consequences. In the current economic context, decisions have resulted in injections of liquidity into the banking institutions, neglecting the help of homeowners, unemployed persons and stimulation of the economy.

During the current economic crisis, the institutions have underestimated the severity of the recession. It was felt that if banks are given money, the economy will return to normal the flow of the loans will be restored and the housing market will come back to life. The only thing was that all decisions were wrong: restoring the accounts of banks not automatically restored to normal loaning. When the central bank of a country engages in a massive financial rescue program, risking public money, it engages in actions that must be directly held accountable politically and undertaken in a transparent manner.

The argument that if the FED and the Treasury would have saved Lehman Brothers, the whole crisis could have been avoided, is considered by many economists as much nonsense. Lehman Brothers was a consequence, not a cause. Regardless of whether it was saved or not, the global economy is headed for much difficulty. The Lehman collapse has most likely accelerated the process generated by the decentralized decisions, but it should not have influenced avoiding the economic decline.

The belief that markets can regulate themselves has resulted in the most massive state intervention on the market until the present day. Decisions were taken for each financial institution without even the benefit of a minimum set of clear principles. In the current crisis the state has assumed a new role that of the last resort risk bearer. When private markets were about to disintegrate, the entire risk was transferred to the state. Social safety net should focus on the protection of individuals, but the safety net has been extended to institutions with the belief that if this is not done, the consequences will be severe.

History and experiences of other countries provide a great wealth of information about how to treat economic crises. Decisions should be able to be served the theory, the empirical data and the rational common sense, to design a package of measures to stimulate the economy in the short term and to strengthen it in the future.

Unfortunately, trust could not be restored only through speeches expressing confidence in the economy. Repeated statements on behalf of the European central governments and banking institutions, that the economy rests on solid foundations, with anchored fundamental principles, were contradicted by the consequences. What the government claimed, was not credible and the facts of the institutions have undermined trust.

An important lesson of this crisis is that it requires a collective action, that the state plays a role that was emphasized in several lines. The markets were allowed to shape the economy, but on this occasion they have shaped the society in which we live. The way the market has changed the thinking is illustrated by decentralized decisions and agreements concluded in the years before the economic downturn. The current context brought to the surface a serious and difficult to correct fundamental moral deficit. No matter how we see things, the institutions and decisions taken, both during and after the crisis, have not lived up to the moral standards we should aspire. Nowadays, almost everyone is claiming innocence. There was individualism, but no individual responsibility and on the long-term, the company cannot work well if people do not take responsibility for the consequences of their actions.

CONCLUSIONS

The experience of the European economic decline does not mean that over the years a new generation, confident that it will not fall prey to the errors of the past, will appear. Human ingenuity knows no boundaries and in any system designed there will be those who will discover how to bypass laws and regulations designed to protect.

But if institutions do their job well, there will be fewer accidents and when they arise, however, they will be less expensive. The role played by each one must be balanced with the role of others, and the way in which the pieces are assembled and glued in their places influences the probability of future crises as well as the social justice and equity feeling.

The crisis has revealed not only flaws in the predominant economic model, but also the flaws in the contemporary society. Too many people have taken advantage of others, and the feeling of confidence was crumbled.

A society in which materialism dominates moral commitment was created, in which the rapid growth achieved is not sustainable, in which the rapid growth is not durable, in which it does not act as a community because individualism and market fundamentalism have eroded the sense of collectivity and led to the exploitation of the naive and defenseless and to the increasing division of society.

The economic decline has brought to the fore and has accelerated the erosion of trust. Trust has been considered a given fact, and the result was that it shuttered substantially. If there will not be fundamental changes, society will never be based on trust, altering social relations, changing the sense of belonging to a community and affecting the economy efficiency.

Not only have the institutions been modified, but also the rules of capitalism itself. It proclaimed that for the favored institutions there is very little or no market discipline. A capitalism with unclear rules was created, but with a predictable outcome: future crises, over-assumption of the increased risk and inefficiency. It taught the importance of transparency, but offered the financial institutions even greater opportunities to manipulate their accounting data. European states saw what bad management of globalization risks meant. But the reforms they hoped for in the management of globalization seem not to have disappeared from the distant horizon.

The crisis is not over, and the future course of history is uncertain - what can be said is that the economic recovery is not situated on solid grounds and that the European economy remains fragile.

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