AN ANALYSIS OF THE CRISES' CYCLICITY IN THE MARKET ECONOMY

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Abstract

The social-economic phenomena and processes have a cyclical character, which falls within the natural development of the economic activity. Periodically, national economies or certain economic branches are affected by states of crisis, of unbalance, which disrupt the normal course of the economic activity and development. The occurrence of fluctuations in the economic field gives birth to economic cycles, defined as the time separating two economic or financial crises. Crises represent a deregulation, a sudden disorder of the economic balance, but they are necessary in the sense that they "are an indispensable sanction of management errors" and the problem is not the elimination of all crises, but only of those which "weigh heavily on the economic activity and are a systemic risk". The main causes of an economic crisis are of a political, social or financial nature. Romania has been affected by the crisis at the commercial level, its exports being reduced and at the financial level, by the limitation of the access to external financing, reflected in the depreciation of the domestic currency. The analysis of the Balance of External Payments (BEP) in the period January-October 2011, shows that the deficit of current account of the BEP was of 4,097 million Euros, having fallen by 9.5% comparing to the same period of 2010, a situation explained by the reduction of the trade deficit by 12.7%.

Keywords: *economic crisis, financial crisis, economic cycle, the balance of external payments, the trade balance*

JEL Classification: B_{26}, E_{21}, E_{32}, G_{01}

Introduction

The economic evolution is not linear, but fluctuant, both in time and from one country to another. Periodically, the national economies or certain economic branches are affected by states of crisis, of unbalance that disturb the continuity of the normal functioning and development of the economic activity.

The analysis of the fluctuations in the economic field highlight the existence of economic cycles, defined as *the periods of time separating two economic or ... ises*. The crises represent a deregulation, a sudden disturbance of the ... alance, but they are necessary in the sense that they represent "an ... e sanction for the management errors" and the issue is not their

complete elimination, but only of those that "weigh hard on the economic activity and represent a systemic risk".

The cyclical evolutions are complex as there is neither a general pattern of the economic cycle, nor identical cycles, in terms of duration and configuration of phases, in the same country or in different countries. The governments and the economic agents try to implement measures that should reduce the negative effects of the economic cycles, especially of their recession phases, although any economy has an objectively determined cyclical evolution. From among the multiple causes of the cyclicity, the efficiency of the production factors' utilization is the most important.

The analysis of the economic cycles shows that, in terms of length, they can be of three types: on a short, medium and a long term. We can distinguish between two main phases of the cyclical movement:

- *The expansion* (the economic boom) – characterized by a production growth, rising employment, salaries and profit, growth of the national income. Prosperous businesses are set up and cheap credits are offered by the banks. The economic efficiency rises (new technologies are introduced).
- *The depression* – when economic unbalances occur (the offer is larger than the demand), the labour productivity decreases, as well as the profit of the companies. The credits and the investments become more expensive and consequently less numerous.

The coming out of a crisis should be done by initiating a new expansion phase that should lead to a new increase of the demand in comparison to the offer, the production factors market being thus balanced. The short cycle is defined as a wavy movement lasting for about three years and being included in the medium term cycle. There are two phases in this process, the expansion and the contraction, which are influenced by the mechanism of stock formation and the market specificities.

The long cycle develops on a period of 40-60 years of economic evolution and consists of two phases: an ascending and a descending one. The ascending phase is characterized by years of prosperity, high rhythms of growth in the fields of national income, production, sales, investment, standard of living. Unlike it, the descending phase means a decrease of the economic growth rhythm, negative economic phenomena caused by the modifications in the structure of branches and sub-branches, in the structure of consumption and economic agents' behaviour.

We can also speak about a century old economic cycle whose main cause might be the evolution of the scientific research and of scientific innovation. The decade old cycles occur on the background of the century old ones.

The analysis of the world economy demonstrates that, in time, it has been affected by numerous economic crises. We can define the economic crisis as a phase of the economic cycle, characterized by a relative surplus of offer in comparison to the population's limited buying capacity, which will lead to a situation of uncertainty regarding the future, to the decrease of production, bankruptcies, unemployment, etc. It is however believed that the beginning of a crisis is a moment of qualitative change for an economy. Until the beginning of the

19th century there were under-production crises causes by natural phenomena (draught, floods) and by social-political situations (epidemic diseases, wars).

The market economies are characterized by over-production crises, triggered by the increase of the offer more than the demand, the effect being the goods and services on the market will not sell anymore and the companies will reduce their production.

NBER (National Bureau of Economic Research) defines the crisis as "a significant decrease of the economic activity, for more months, reflected in the decrease of the GDP, individual incomes, level of employment and in the diminution of industrial production and consumption".

The economic crisis can take the form of a stagflation, a recession or an economic depression which can lead to an economic collapse. We can speak of economic depression when the GDP negative growth (more than 10%) lasts for more than two semesters. The economic depression is considered a severe form of economic crisis and of recession, being characterized by a severe fall of one or more economic branches.

The economists classify the crises as:
- *social crises* (rising inflation, unemployment, poverty);
- *financial crises* (increased volatility of the capital markets, fall of the stock exchange followed by spectacular recoveries);
- *political crises* (that can end up in wars);
- *local or international crises;*
- *crises caused by natural disasters*;
- *general economic crises.*

In general, economic crises are generated by financial, political or social causes. Then, *the financial crisis* is a form of manifestation of the economic crisis which shows the lack of trust in the financial system and leads to the dereglementation of the market mechanisms, the decrease of the stock exchange transactions – these being a good indicator of different economic sectors' state of health. *The economic crisis* is a situation when the money demand is higher than the offer and the liquidities are very low, because the money on the market are withdrawn from the banks. The financial crisis will thus lead to an economic crisis.

When the market is affected by severe deregulations, they will be mirrored in the performance of the listed businesses, the next step being the decrease of the savings and investments, as well as the increase of the bank interest on the market.

Modern economic theories, attempting to explain crises, reject the idea of a general theory of economic-financial crises, which would use a general definition. It is believed that each crisis is unique and it represents an accident of the history, being generated by specific factors, occurring in specific social, economic and political circumstances.

We will refer in the following lines to the points of view of some specialists in the field of economics, who studied the problem of the economic crises:
- **Milton Friedman**, promoting the theories of the market economy and the theory of the state's minimum interference in the coordination of economy,

believes that: "the economic actors are always rational and in a market economy speculations are not possible, because the so called *speculation* is the investors' attempt to protect themselves against the governments' irrational actions".

- **Charles P. Kindleberger,** in his work *Manias, panics and crises: a history of the financial crises*, believes that the financial crises are an inherent characteristic of the world capitalism.
- **Hyman Minsky** supports the theory of the "*financial instability",* as a factor generating financial crises. Using this theory, H. Minsky demonstrates the unstable character of the capitalist system, in which the financial crisis is an element that cannot be avoided, but can be predicted. His theory says that the beginning of the crisis is due to a strong exogenous factor in a certain economic domain, followed by the increase of profit opportunities, by an investment fever fed by the growth of bank credits, until the market reaches a peak, beyond which there is a danger of price fall, on an overestimated market. When prices fall, the crisis will affect the investment sector and then the crediting zone, followed by a chain of bankruptcies, and, from this point on, the economy will find itself in a recession period or even in a depression. This stage is followed by a period of recovery and the market will reach a new state of balance, after having paid a very high price.

The financial crisis started in 2007, ten years after the last financial crisis in South-Eastern Asia can be considered the end of a decade cycle or a business cycle. This international crisis has affected Romania as well, but the Romanian banking system was not affected in a direct way as it was not exposed to toxic assets, due to the cautious measures taken by the National Bank. The crisis has hit the Romanian economy at a commercial level (reduction of exports, from the Balance of External Payments), and at a financial level (decrease of the crediting activity, limitation of the access to external financing, depreciation of the national currency).

The financial crisis started in 2007 deeply affected the European economies, which felt the effects mainly on *the capital market* and on *the labour market*:

From a financial point of view, one can notice:
- effects on the financial institutions (bankruptcies, restructuring);
- effects on the level and quotations of the stock exchange (the volume of the stock exchange transactions went down);
- effects on the investors' behaviour on the market, they have left the capital market and changed their investment decisions;
- effects on the regulations on the capital market (intensification of controls).

On the labour market one can notice:
- a global crisis of the work places;
- decrease of the salary incomes (resulting in a lower standard of living);
- the implementation of measures meant to support the vulnerable social categories.

In order to support the national economies, the states of the world contracted loans from the domestic and foreign markets, which led to a boom of the public

debts. This burden of the public debts weighs hard on the public finances and on the banks' capacity to offer loans to the private sector. An attempt was made to finance the increased budget deficit from state loans, using both domestic and foreign sources, which would lead to a rise of the public debt (according to Table 1), and consequently to a rise of the fiscal weight borne by the tax payers. Thus, in the future, the reimbursement of the loans will lead to a decrease of the investment funds and, therefore, of the economic growth. The analysis of Table 1 shows an increase of Romania's foreign debt from 38,711 mil. Euros in 2007 to 75,612 mil. Euros in 2011, while the loans from the IMF of 5,686 mil. Euros in 2009 amounted to 10.231 mil. Euros in 2011.

Table 1

Romania's Foreign Debt

	Romania's Foreign Debt – mil. Euros				
	2007	**2008**	**2009**	**2010**	**2011**
I. Medium and long term foreign debt	**38,711**	**51,762**	**65,616**	**72,909**	**75,612**
I.1. Direct public debt[a]	8,181	9,028	11,984	16,158	1,956
I.2. Publically guaranteed debt[b]	2,019	1,721	1,517	1,708	1,509
I.3. Debts not guaranteed publically	25,292	35,545	39,186	37,733	35,904
I.4. Medium and long term deposits of non-residents	3,219	5,545	7,242	8,228	8,452
I.5. IMF Loans[c]	---	--	5,686	9,082	10,231

Note: a) foreign loans contracted directly by the Ministry of Public Finances and the authorities of the local public administration according to the legislation on the public debt, and also the Emergency Ordinance no. 99/2009 on the ratification of the *Stand-By* Agreement between Romania and the IMF; b) foreign loans guaranteed by the Ministry of Public Finances and the local public administration, according to the legislation on the public debt; c) loans from the IMF according to the *Stand-By* Agreement with Romania, excluding the amount received by the Ministry of Public Finances from the IMF according to the Emergency Ordinance no. 99/2009.

In Romania, the economic crisis has generated massive unemployment in most of the economic sectors, correlated with the decrease of production and the cessation of investments, especially at the beginning of the year 2009, as a consequence of the decrease of orders, on the background of the deepening economic and financial world crisis. The worst affected domains were the car industry, the manufacturing and the textile industry, the constructions and the wood industry. The real estate market was the most severely affected sector, as it was almost frozen in October 2009, on the background of an international financial blocking doubled by new crediting limitation measures imposed by the National Bank of Romania.

Although Romania has theoretically gone out of the recession on the 31st of March 2011, the Romanians have not felt it yet and they will not feel any improvement in the near future as their economic situation will not change too soon.

The economists have been interested in the study of the balanced economic growth, when the production growth is compatible in the long run with the macroeconomic balance (equality between the level of savings and investments) and respectively with the full use of the labour force. In the process of transition, there are certain critical elements that shall not be ignored: the savings rate (SR) and the investment rate (IR), which we can analyse using the data in Table 2, containing the calculations for the main economic indicators.

Table 2

The main macroeconomic indicators

- mil. Euro -

No.	Indicators	2009	2010	2011 * forecast	2012**	2013**	2014**	2015**
1.	**A=FC + I**	124,693	128,551	135,557	142,893	153,017	164,880	178,030
2.	FC	94,919	96,297	100,189	104,671	111,185	118,430	126,211
3.	**I**	29,774	32,254	35,368	38,222	41,832	46,450	51,819
4.	**NE = E – I**	- 7,164	- 6,543	- 6,270	- 6,840	- 6,870	- 7,710	- 8,680
5.	**In**	- 1,899	- 1,741	- 2,850	- 4,040	- 5,040	- 5,750	- 6,210
6.	**CT**	4,149	3,416	4,000	4,445	5,340	6,420	7,250
7.	**BCA**	- 4,915	- 4,969	- 5,120	- 6,435	- 6,570	- 7,040	- 7,640
8.	BCA/ GDP %	- 4.2	- 4.1	- 4.0	- 4.7	- 4.5	- 4.5	- 4.5
9.	**GS = I + BCA**	24,859	27,285	30,248	31,787	35,262	39,410	44,179
10.	**DGNI= A+NE+In+CT**	119,779	123,583	130,437	136,458	146,447	157,840	170,390
11.	**GDP =A + NE**	117,529	122,008	129,287	136.053	146.147	157,170	169,350

Sources: www.insse.ro; www.cnp.ro; http://www.mfinante.ro.

* forecast data;

** provisional data (forecast – The National Forecast Commission).

Legend: I – Investments, including the gross fixed capital formation, the stock variation and the statistical differences; A – absorption; FC – final consumption (private consumption, governmental consumption); NE – net export of goods and services; In – incomes; CT – current transfers; BCA – balance of current account; GS – gross savings; DGNI – disposable gross national income.

The specialized literature defines the correlation among these rates as *the balance relationship among savings, investments and the balance of current account*:

$$\frac{SCC}{PIB} = \frac{EB}{PIB} - \frac{I}{PIB} \quad \text{or} \quad \textbf{BCAR = SR – IR}$$

$$\frac{BCA}{GDP} = \frac{GS}{GDP} - \frac{I}{GDP}$$

As a main macroeconomic indicator, the GDP has grown by 3.8 % in 2010 comparing to 2009, and the data forecast by the National Forecast Commission show a steady growth until 2015. The BCA (deficit / balance of current account)

was of 4,969 mil. Euros in 2010, one of the lowest in the last seven years. The balance of current account was influenced by the increase of the service balance deficit, of 637 mil. Euros, which was 2.2 higher than in 2009. This situation occurred although the payments for freight transport and tourism increased, but the incomes from other transport services decreased. The current transfers figure was a positive one (3,417 mil. Euros), but, comparing to 2009, it decreased by 17.7 %, because of the diminution of the sums transferred by the Romanians working abroad and of the EU funds.

Although it had a negative value of – 5,906 mil. Euros, the trade balance deficit had a positive evolution comparing to 2009, that is a decrease by 14 % comparing to 2009. The structure of the trade balance shows that deficit situations characterized the intermediary goods, the raw materials and surplus situations were registered for consumption goods and capital goods. But 74.5 % of the trade deficit was caused by the inter-community trade.

Due to the 66% degree of openness of the economy in 2010, the imports were covered by exports in a proportion of 86.3%. The structure of exports shows an improvement, that is 91.4 % of the total exports were accounted for by the manufacturing industry. In their turn, imports rose by 20.1 % comparing to 2009, and this rise was due, on the one hand, to the volume increase of imports by 53.1 % and, on the other hand, another increase by 46.9 % was generated by the increase of the foreign prices.

We can analyze the relationship among savings, investments and the current account weight of the Balance of External Payments (BEP) within the GDP using the following rates (Table 3):

Table 3

Savings rate (SR), investment rate (IR), weight of the balance of current account within the GDP (BCAR) %

	2009	2010	2011	2012**	2013**	2014**	2015**
Savings rate: $RE = EB/PIB \cdot 100$ SR = GS / GDP x 100	21.2	22.4	23.4	23.4	24.1	25.1	26.1
Investment rate: $RI = I/PIB \cdot 100$ IR = I / GDP x100	25.3	26.4	27.4	28.1	28.6	29.6	30.6
Weight of the balance of current account within the GDP: $RSCC = SCC/PIB \cdot 100$ BCAR = BCA / PIB x100	- 4.2	- 4.1	- 4.0	- 4.7	- 4.5	- 4.5	- 4.5

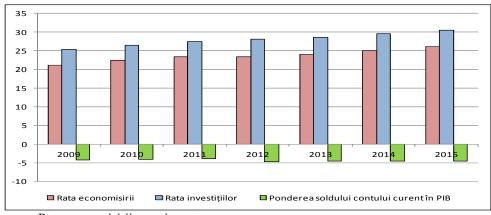*Source:* www.insse.ro ; www.cnp.ro; http://www.mfinante.ro.
* forecast data;
** provisional data (forecast – National Forecast Commission).

The analysis of the balance relationship shows a positive, ascendant trend of the two rates: the savings rate was of 22.4 % in 2010, which means a slight growth of 5.7 % comparing to 2009, while the investment rate was of 26.4 % in 2010, which means a 4.3 % increase comparing to 2009. The positive evolution of the two rates assured a low level of the balance/deficit of current account, which, according to the 2011-2015 forecast, will not exceed 5 %, a figure that represents a normal unbalance; however, the government should take the necessary measures to restore the balance of foreign payments.

We can analyse the connection between the rates using Graph 1, which shows an initiative of the government to increase the investment rate. The decision should support the economic growth, while maintaining the balance/deficit of current account below 5 %.

Graph 1

The balanced relationship among saving, investment and balance of current account

Rata economisirii = saving rate;
Rata investiţiilor = investment rate;
Ponderea soldului contului curent în PIB = weight of the balance of current account within the GDP.

Pre-crisis Romania managed to obtain consumption based economic growth, but for a sustainable economic growth the efforts should be directed towards sectors with a high value added. Consequently, one of the financing sources for investment expenses will be represented by the domestic saving. It is forecast that the domestic saving will cover the investment, which will increase from 60% to 82% in 2011. Romania's domestic policy has been affected in the past years by an increase of the budget deficit, but, on the background of the public expenses increase, the budget deficit characterized many countries. In fact, any economic sector spending more than the incomes it generates will have to borrow money in order to pay the extra expenses.

If we analyze the balance of current account of the Balance of External Payments (according to Table 4), we will notice an increase of the deficit/balance of

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current account by 2.92 % in 2011 comparing to 2010, and by 15.5 % comparing to 2009 – the calculation being made based on updated data and provisional data for 2011. The structure of the current account for 2011 demonstrates a favourable situation for the position Current Transfers which had a positive balance of 3,737 mil. Euros, that is a slight increase of 4 % comparing to 2010. The service balance was characterized by a slight decrease of 5 % comparing to 2010 – the highest growth being accounted for by the transport activity (929 mil. Euros). The trade balance had the highest deficit, of – 7,464 mil. Euros, which means a decrease of 2 % comparing to the level in 2010. This deficit of the trade balance is mainly caused by the diminution of the export activity in this period of financial crisis. The balance of incomes of 2010 shows that the 406 mil. Euros labour incomes reduced the large deficit produced by other capital investments, of -2.096 mil. Euros, especially interests.

Table 4

The current account of Romania's balance of external payments

- million Euros -

	2010 *			2011**		
	CREDIT	**DEBIT**	**NET**	**CREDIT**	**DEBIT**	**NET**
CURRENT ACCOUNT (A+B+C)	**50,912**	**56,430**	**- 5,518**	**59,613**	**65,292**	**- 5,679**
A. Goods and services	43,989	51,185	-7,196	52,291	59,376	- 7,085
a. Goods (FOB export – FOB import)^s	37,368	44,970	- 7,602	45,018	52,482	- 7,464
b. Services	6,622	6,220	402	7,275	6,893	382
B. Incomes	925	2,837	- 1,912	1,237	3,573	- 2,336
C. Current transfers	5,997	2,404	3,593	6,082	2,345	3,737

Note: * updated data; ** provisional data.

Conclusions

Consequently, the national and the global economic growth will not reach the level they had in the past years too soon, a massive re-balancing of the balance of external payments being necessary for reaching this objective. Furthermore, the crediting terms will remain restrictive although the liquidities on the monetary markets have improved. The worsening of these financial conditions has affected the economic growth and the low economic activity has led to many bankruptcies. It has also been noticed that the economic crisis has had negative effects on the export oriented economies, which were not prepared to absorb the structural shock

of the low demand for exports. The world's states are nowadays confronted with a difficult crisis, which, nevertheless, respects the cyclicity canons.

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