Countercyclical Economic Policies in Times of Crisis

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Abstract: The countercyclical policies aimed to correcting excessive economic activity and reducing negative effects of crisis and economic recovery. In Romania we identify a series of causes that led to the economic crisis like: the mismatch economic policy mix with business cycle phases, underdeveloped capital market, the mismanagement of public expenditure, the shortage of skilled labor and many other.

Keywords: countercyclical; crisis; economic activity

JEL Classification: A1

1. Countercyclical Economic Policies

The economic policies in crisis conditions, named also countercyclical , aimed at correcting excessive economic activity and reducing negative effects of crisis and economic recovery. They are based either on aggregate demand influence or the influence of aggregate supply.

Countercyclical policies vary in a business cycle. If in the boom conditions, countercyclical policies should consider measures to stabilize the economy, in recession phases, they should aim recovery measures supporting economic activity, stimulate investment, stimulate consumption, boost credit or production.

Measures of economic recovery policies, based on Keynesian theory, which have influenced the aggregate demand, can be grouped into three broad categories:

The public expenditure policy that is based on increasing governmental spending in times of crisis, even at the cost of increasing deficit in order to stimulate aggregate demand through state acquisitions and public sector investment. In Romania, the economic development from 2009 to 2011 shows that was an increasing at costs with a result in a budget deficit but not with a stimulating the aggregate demand.

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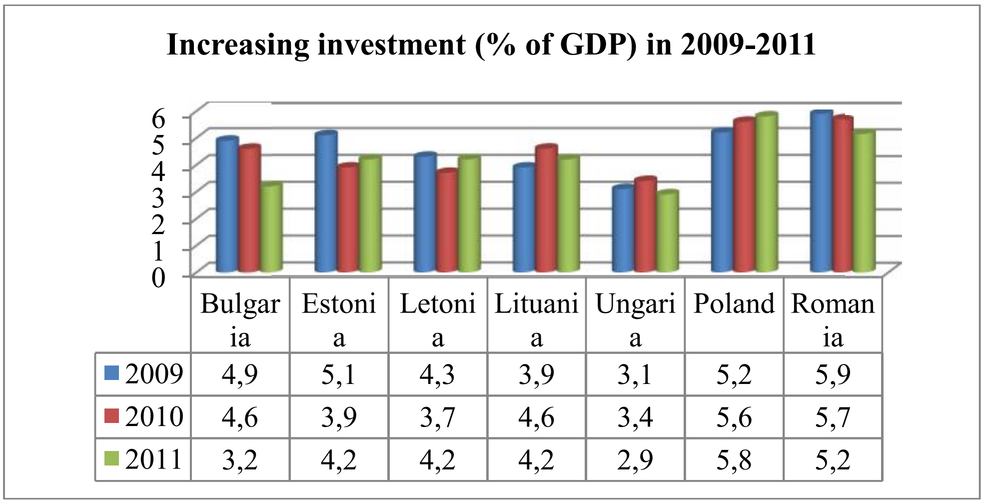

	Bulgaria	Estonia	Letonia	Lituania	Ungaria	Poland	Romania
2009	4,9	5,1	4,3	3,9	3,1	5,2	5,9
2010	4,6	3,9	3,7	4,6	3,4	5,6	5,7
2011	3,2	4,2	4,2	4,2	2,9	5,8	5,2

Figure 1

Source: Eurostat

Public investment fell as a share of GDP since 2009, reaching in 2011 a level of 5.2%, the maximum being reached 6.6% in 2008. Compared with emerging countries in Eastern Europe, Romania is ranked second in the share of public investment in GDP, after Poland (5.7% in 2011). Romania has had, in 2011, a growth rate of 2.5%, the lowest with Hungary and Bulgaria with a growth rate of 1.7% each, from which we conclude that most public investment were unable to generate additional multiplier effects and training necessary for stronger economic growth.

1. Monetary and credit policy which aims to boost stimulate credit for an upper level of the aggregate demand and ensure an optimal level of employment by lowering the interest rate during the recession and curb demand by raising interest rates during the economic expansion.

In Romania it happened quite different in terms of monetary and credit policy. During the economic boom, interest rates were low and the lending process has been relaxed. Contrary to economic theory, in the phase of recession interest, rates have shown a certain rigidity in the downward trend especially for governmental loans, while increasing the degree of tightening credit conditions. These measures fully procyclical are generated primarily by the behavior of banks, which cannot be countercyclical in terms of risk and instability, their purpose being to increase or maintain profits.

2. Tax policy, which can stimulate consumer demand and investment, reducing taxes during the recession and increasing taxation in the phase of expansion in order to limit the aggregate demand and mitigate inflation.

The economic crisis has brought changes in terms of fiscal policy. The crisis management adopted by each country, meant for some increasing tax burden, for others its reduction. In Romania, the tax burden increased from 17.5% in 2009 to 19.1% in 2011. VAT increased by 5 percent as well as in Greece (18% to 23%), the largest increase in EU after Portugal, where it increased by 6 percent (from 17% to 23%). Countries of Central and Eastern Europe, Bulgaria, Estonia, Lithuania, Hungary and Czech Republic have decreased tax burden, some of them with spectacular results in economic recovery.

From the above, we conclude that countries that have adopted a policy of stimulating faithfully aggregate demand had remarkable growth: over 5% Lithuania and Latvia, and Estonia over 7%.

We bring into question the countercyclical policies aimed primarily influencing aggregate supply by providing a favorable climate for free market and a non interference of the state in its mechanisms of operation. This is a new doctrinal orientation, called supply doctrine, published in the 80s in response to Keynesian theory that through its representatives Arthur Laffer, Norman True, Paul Craig Roberts believes that a dirigisme by a tax system which leads to stagnation of productivity initiative discourage. The supply doctrine is based on Say's law outlets and focuses on stimulating productive activity of entrepreneurs, the aggregate demand being a consequence of the supply not a cause of it.

Policies aimed at stimulating economic recovery by offering savings and domestic investment, foreign investments, reduce the tax (direct taxes), public spending cuts. They contest the efficacy of systematic deficit and the Keynesian investment multiplier.

For Romania to adopt such a policy to encourage the supply and production, the private sector is in great need of economic and fiscal incentives accompanied by investment in infrastructure and human capital and a stable and competitive business environment.

Both policy to stimulate demand and the supply side there are tools in a greater or lesser influence on economic growth. It would therefore be desirable effective combination of the two types of countercyclical policies. An offer of goods and services not adequately meets demand and vice versa, will be adopted policy but not only generates the expected effects. Furthermore, we believe that concerted action of the free market with the state through transparent surveillance and predictable policy meet internal and external economic shocks we face.

Crisis management should be a complex and continuously supported on multiple levels (economic, political, social) from the pre-crisis, during its deployment and post-crisis phase to reduce and maintain control negative effects follow as small economic and social plan.

The premise of crisis management is the prompt and appropriate response of policy makers at international and domestic events that threaten the economic stability of the country. During crisis management, an important role is the readiness of the management team consists of government ministries, prefectures, municipalities to ensure a healthy economic environment (Kyloh, 2009).

An effective crisis management depends on the coordination of regional efforts, particularly in the European Union as a leader in the G20 through special joint measures to promote financial stability and real economic recovery.

As Romania was a country severely affected by the crisis management strategy should aim at long-term sustainability, setting the necessary stage foundation for economic recovery and macroeconomic stability and ensuring its financing capacity.

2. Conclusions

In 2008, the world economy went into the greatest economic crisis since the Great Depression of 1929-1930. Because of the high degree of interdependence of world economies were affected both developed and emerging economies.

Growth periods were found to be poorly managed economic crisis demonstrated inability regulatory institutions to adapt to economic realities.

In late 2008, after a period of unbalanced growth based on high demand and low production, Romania entered the crisis.

The fact that the Romanian banking system has not been contaminated by toxic assets (one of the main causes of the global financial crisis) was not enough for Romania to be avoided recession. The real economy has experienced economic decline after a long period of economic boom also accompanied by the accumulation of macroeconomic imbalances: the current account deficit, budget deficit and public debt.

Analyzing external circumstances, the economic crisis has spread to the Romanian economy through three main channels: trade, financial and confidence.

Prolonged and destabilizing effect of economic crisis on Romania and elsewhere, was amplified by the fact that our country is already facing a crisis of a structure generated of an ineffective adaptation by domestic production to international circumstances, the loss of competitiveness leading to negative impact on the balance of payments.

At the root of the economic crisis that Romania still faces, we can identify common causes that led to the global crisis and the national economy and specific causes.

Common causes are:

1. Cheap money policy pursued by Central Banks;
2. Increasing asset prices in the housing market;
3. Uncontrolled expansion of credit;
4. Increased appetite for high-risk assets;
5. The phase shift between the financial system controlled by Central Banks and the real economy

Specific causes of the national economy are:

1. The mismatch economic policy mix with business cycle phases;
2. Underdeveloped capital market;
3. The mismanagement of public expenditure;
4. The overgrowth of consumption relative to savings and investments;
5. The unpredictability's fiscal policy which has been a key generator of risk, negatively influencing investment decisions and consumption decisions;
6. The shortage of skilled labor;
7. The increased share in GDP of services and commerce to the detriment of industry, the only sector that can lead to sustainable economic growth;
8. Poor collection of financial resources from the state budget;
9. Strongly influenced the elections cycle both phases of the business cycle and monetary and fiscal policy decisions.

2009 and 2010 meant for Romania, years of economic contraction. In the European Union, in 2010, few were countries that have economic contraction: Ireland, Greece, Spain, Latvia and Romania.

Two consecutive years of economic downturn is explained in the case of Romania, through the imbalances accumulated during the period 2000-2008 and that the most important levers of state led to the amplification of business cycle variations.

A mix of economic policies while countercyclical prudential could restrain the aggregate demand expansion, component has played an important role in overheating. Another factor that has contributed to macroeconomic instability extension was the public debt structured wrong. Large current account deficit clearly shows that Romania is dependent on loans. In Romania, part of the state loans has as destination the budget deficit and debt refinancing and elsewhere were channeled into investment projects without, however, generate multiplier effects on real output. For macroeconomic stability and sustainable growth, Romania must renounce to the chaotic growth model based mainly on consumption and orientation towards a model based mainly on efficient investment, exports competitive and highly skilled workforce. However, given the global macroeconomic instability and particularly in the euro area, to achieve and maintain stability we need to develop other sectors and growth engines. Industry, which had a relevant contribution to growth in 2011, was developed based on external demand and the conditions under which exporters were favored by exchange rate depreciation. It can also be put emphasis on production for the domestic market. Economic policies that act to stimulate economic growth must include a suitable tax system, mechanisms to stimulate research and development. Both economic realities and economic growth models lead to the idea that innovation influences a largely economic growth process. How innovation can be promoted only through investment, we can say that these are the most effective way to sustainable growth.

Crisis management and the solutions to leave the crisis depend largely on the initiatives promoted by politicians and political force measures which they have at their disposal to achieve those objectives (Daianu, 2009). Macroeconomic policies should be established in a broader framework, able to rethink the evolution of the Romanian economy and shift position that we could get both on the European and world markets

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