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Working Paper

HOW ROMANIA INOCULATED HER ECONOMY FROM THE FINANCIAL MELTDOWN IN GREECE

A Keynesian Perspective

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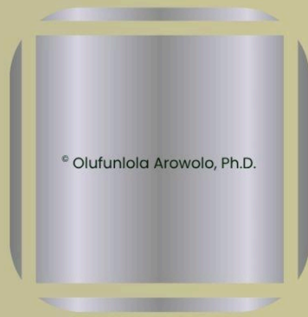
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Introduction

Market instability - owing to several factors, the chief of which was an abrupt change in the ability to secure new lines of credit - paved the way to the global financial crisis between 2008 and 2009 (henceforth global crisis). Cash flows became stifled and economic growth in global economies saw steady decline. Currently, Greece's dire economic condition has many economists keeping a closer eye on Romania, not only because of their geographic proximity, but also because of the significant number of Greek banks linked to the banking system of Romania. Roughly 25% of the Romanian banking market is shared with Greece, yet despite this potentially pernicious link, Romania is considered an economic "Tiger" in Eastern Europe owing to her vast portfolio of natural resources and sound fiscal policies.

When Greece entered the Economic and Monetary Union, financial growth expectations were positive as credit conditions were not only easy, but were burgeoning at rates far above the mid-term threshold rate of expected market growth. For Romania, joining forces with the European Union spearheaded economic and modernization reform. Through the application of packages geared towards national stabilization, and with the implementation of structural adjustment programs, Romania made a lightning fast recovery from the financial crisis that wreaked havoc on a global scale. Greece, however, has remained bowled over and is struggling to regain its economic footing.

Prior to the global crisis, Greece espoused the Keynesian policy of unlimited borrowing in order to fund government programs – which is believed to have contributed to her demise.

Further, rigid economic policies became breeding ground for short-run inefficiencies that guaranteed collapse. Meanwhile, at the behest of the Romanian governing bodies, practical macroeconomic policies were enacted to redress short-term inefficiencies - the success of which helped usher in coherent strategies that strengthened the Romanian economy over the long-term.

At the end of 2009, the Greek deficit was 16%, and debt-to-GDP was at 125%. This was in clear violation of the Eurozone policy that national debt for each member state cannot exceed 60% of GDP, and the annual deficit amount cannot exceed 3%. Romania, although was in good standing with a 2009 debt-to-GDP ratio of 23.6%, it had a deficit of 7.2%.

Greece has the Eurozone on edge, but the growing consensus is that the Eurozone will not allow Greece to self-destruct because the economy of the Eurozone is intricately woven to that of Greece. Each stimulus package handed to Greece is a source of comfort to Romania as it inoculates the Greek banks on Romanian soil. So although the Keynesian policy approach provided a stopgap measure for Romania, post global crisis, Keynesian policies failed to stop a deep crisis from breaking out in Greece, and may have even contributed to the onset, further deepening of the Greek dilemma. Based on this background information, the following research question emerges: Why is Romania able to inoculate its economy from the Greek financial meltdown?

Perspective I : Keynesianism: Government Intervention

Deficit spending alleviated short-term inefficiencies in Romania, but deepened depression in Greece. For Greece, Keynesian fiscal and monetary policy was a recipe for depression, but for Romania, it spelt economic resuscitation – the difference was in the variation of capitalist mechanisms each nation espoused.

The 2008 financial crisis led governing bodies all across Europe (and in the U.S.) to undertake an unprecedented bailout using massive amounts of money against ballooning debt in the background - governments bailed out banks, financial institutions. Markets and financial system efficiency was at an all-time low. It was clear that the markets could not self-regulate, Smith's invisible hand became a visible economic impossibility. The financial crisis threw open a huge amount of uncertainty about finance, the markets, and the capitalist economic system. In particular, it opened up an avenue for the revival of Keynesian economics. Keynesians criticize capitalist economies for espousing economic processes that make market self regulation a near impossibility.

Ironically, for Greece, government intervention and implementation of fiscal policies to redress market collapse has driven the economy further from the equilibrium expected to result from market self-correction. Marx vehemently challenged the notion of a self-regulating market as a mechanism for commandeering the production and circulation of commodities.

Keynes believed the market failure does not originate with lack of capital, per say, but with the nature of the money system - more specifically, with investors who had lack of faith in the market economy and withhold financing, which leads to a lack of demand in the economy. Keynes advocated pumping money into the market to reverse the crashes inherent to capitalist business cycles. Clearly, for Greece, and in contrast to the Keynesian approach, pumping money into the economy is not the answer to a capitalist slumps/recession. The Greeks have struggled with paying public pay rolls, wages, and pensions - deficit spending not only spelt trouble prior to the global financial meltdown, but the effort to eliminate deficits when the crisis hit via austerity led to economic depression, a staggering unemployment rate of 25%, and the collapse of health care, banking, and other public services.

Greece appears to be the ultimate paradox - bankrupt economies usually reach for stimulus spending (versus austerity), however, the Keynesian stimulus policy of borrowing to fund social programs has been blamed for pushing Greece into its current dismal corner, and further austerity is likely (arguably) to cripple their economy.

The Keynesian bailout approach is forgotten just as quickly as financial transfers hit ailing banks in Greece and Romania - but this to a lesser extent in Romania. Rather than spending money, both governments favored austerity measures - to varying degrees - for example, in Greece, after the first bailout was received, public sector workers were either laid off, or were forced to accept pay cuts at rates upwards of 20%. In Romania, workers had to accept pay cuts of nearly 33%. Both governments have remained judicious in terms of which programs they slashed with deep cuts, in spite of having received funding to sustain them. The desperate bailout to save banking systems, and essentially the global market economy, has proved to be a Keynesian jumpstart that has quickly reverted back to neoliberal austerity.

Romania remains adamant that the Greek crisis (even if it extends into the Greek banks located in Romania and reaches the point of insolvency) cannot affect the Romanian economy because the Greek financial situation reinforces the need to Romania to buckle down on its current austerity measures, that have proven effective in inoculating their financial market from the Greek meltdown thus far. Time will tell how well this economic philosophy will hold.

Perspective II: Keynesianism: Government Spending

Although Greece received a larger financial package than Romania, 90% of the Greek package was used to repay previous debt, unlike Romania, which was able to implement a broader range of macroeconomic stimulus strategies. Thus, only in Romania was the Keynesian approach implemented in its pure form.

Greek austerity measures took on similar life forms as those enacted in Romania, however, unlike Romania, the Greek was already headed towards a downturn prior to the global crisis as debt-to-GDP ratio was higher than Eurozone regulations. Greece’s borrowing habits, prior to the global crisis, led the country to an eventuality that forced debt repayments (post initial bailout) because investors lost faith in the Greek market.

Also, available revenue was not spent on basic needs - revenue spending on healthcare, education and transportation decreased; most public servants were fired, wages were reduced and pension payments stopped. At the same time, taxation was increased - this policy did provide a primary surplus that allowed Greece to meet its debt obligations, but at the grave expense of its economy and its citizens. Unemployment grew from 12.7% (2008) to 27.6% (2013).

Romania received a joint stimulus package financed by the IMF, the European Union, the World Bank and several international financial institutions in the amount of 20 billion Euro. As part of the loan agreement, Romanian implemented severe austerity measures (tax increases, wages and public spending cuts). The Romanian economy was growing faster and by a larger amount, which created revenue for local needs, thus although welfare spending was slashed and taxes were increased, the created surplus allowed Romania to meet its prior debt obligations, whilst using stimulus money to protect and stabilize banks and financial markets. The government also subsidized the energy sector to strengthen competitiveness and encourage private investment. Healthcare reforms were enacted to strengthen infrastructure and curtail wasteful spending on unnecessary treatments. These are just a few of the measures Romania was able to implement.

Of the 240 billion Euros Greece received in bailout money, only 10% was left for reforming the economy. Economic speculators blame the lack of credibility that plagues the Greek government, and inflexible fiscal and monetary policies, for the failure of post-crisis adjustment programs.

Perspective III: Keynesianism: The Labor Market

Changes in aggregate demand for labor in Romania was marginal as compared with dramatic Greek unemployment rates, resulting in devastating short-run effects on employment in Greece, but only marginal effects in Romania.

According to Marx, capitalist economies are intrinsically wired to self destruct (vs. self regulate) because of rampant unemployment, which underutilizes labor capacity. For the classical economist, if unemployment is widespread, it indicates that there is a surplus of workers. Remedying this oversupply of workers necessitates cutting prices and cutting wages, which should eventually send the labor supply back towards equilibrium. Keynes argued that if unemployment is widespread, there is no reason for the economy to come back to full employment - a failure of the system is not self adjusting and will not reduce unemployment, thus governments have to intervene with correct policies and create jobs by spending their way out of a recession.

Unemployment rates sky-rocketed when economic depression hit Greece, thus the mechanism of demand-deficient unemployment requires Greece to suffer through rising unemployment, and allow wages and prices fall in order for the labor market to return to equilibrium. There is no employment target for any of the EU member countries, there is no mandate for keeping and maintaining decent jobs.

Thus, when high unemployment became an issue in Greece, there was no EU “dual mandate” that could, for instance, force Greece to discontinue a certain spending or taxation policy until employment rates pick up. Instead, the success or failure of the member states hinges on how much control is exacted on spending and tax revenues. So if the labor supply is inefficient, it is presumed to be the fault of the individual (not enough education/skills, etc.), thus the issue becomes increasing employability - via education or through entrepreneurship - as opposed to addressing labor demand issues. Greece placed little emphasis on fixing the labor market, and also placed little emphasis on determining whether labor demand was sufficient enough to keep citizens employed. In Greece from 7.8% (2008) to 27.3% (2013). In Romania, unemployment growth was marginal – from 6.1% (2008) to 7.8% (2013).

Growing Greek unemployment was exacerbated by wage cuts, lay offs and pension slashes. Romania was inoculated because although wages were also slashed to create surplus, Romanian austerity measures had a marginal effect on unemployment.

Concluding Thoughts

Romania clamped down on austerity measures, which proved effective in inoculating her economy for the economic meltdown experienced in Greece. Economic speculators blamed the Greek government's lack of credibility, as well as their rigid fiscal and monetary policies, which served as contributing factors to the failure of post-crisis adjustment programs. Greek unemployment figures were exacerbated by wage cuts, lay offs and pension slashes. However, Romania remained inoculated because despite wage slashes, Romanian austerity measures had a marginal effect on the employment market.

Based on Keynesian economic stabilization prescriptions, instead of paying close to 7 billion Euros in interest rates its debtors, Greece can enact a moratorium on interest payments for a time period, during which the interest payments can be redirected towards job creation programs, thus targeting public spending directly on job creation (vs. interest payments). This would serve the role of stabilization, allow for fiscal expansion, and alleviate the unemployment burden in Greece; and, would further inoculate Romania from shouldering the repercussions of a complete financial meltdown in Greece.

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