IMPLICATIONS OF THE ECONOMIC AND FINANCIAL CRISIS IN SOUTH-EAST EUROPE

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Abstract: *Initially triggered in the USA and generated by the chaos in the financial system of the country, the economic crisis has spread in Europe and, thanks to globalization, as a domino effect has spread around the world. Although the first part of 2008 South East Europe has lived with the belief that the countries in this region will be immune to the crisis, since September 2008, the situation has changed notably in these states. The purpose of this study is to describe the issues related to the economic crisis and its impacts on South-Eastern European countries. The first part of the study highlights economic and financial crisis origins, while in the second part the effects of the global crisis are presented and the last part states about implications of the crisis in South-Eastern Europe states.*

Keywords: South Eastern Europe; growth; economic crisis; unemployment rate.
JEL Classification: G01; E24; E31; O11.

INTRODUCTION

This study provides a brief overview of the global financial and economic crisis's impact on South-Eastern Europe countries. To estimate the implications of the recession in the region, it is particularly important to take into account two essential aspects which differentiate South-East Europe from other regions. First, it should be considered that the countries in the area have passed through a process of transition from a planned economy to a market economy. Secondly, the transitional process has involved multiple changes regarding the economic integration of South-East Europe and the near-complete forwarding of international trade flows. Therefore, in the last decade, South-East Europe has experienced a transformation process, unprecedented in the region's history. Democratic reforms, regional cooperation and integration in the economic and financial markets are considerable progress, which were inconceivable 10 years ago.

However, this continuous development was stopped by the financial and economic crisis, a phenomenon initially considered not to be disruptive for South-East Europe. The economic reality proved the opposite and thereby in the fourth quarter of 2008, the region faces severe financial turmoil.

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This situation is stressed out by the evolution of the main macroeconomic indicators: the GDP, the unemployment rate, the inflation rate and foreign direct investment flows that have undergone substantial changes throughout the region.

What results from the survey is that, even though the countries of South-East Europe region have been affected with a certain delay, the negative effects were more pronounced than in developed economies case.

1. ORIGIN OF THE CRISIS

On a theoretical there is no agreement regarding an economic model which can explain the crisis. There is not just one explanation of the economic crisis causes and consequently the anti-crisis solutions formulated in macroeconomic theory differ substantially from one approach to another.

The main schools of thought which tackled the problem of business cycle and financial and economic crises are Keynesian, Monetarist and the Austrian School of Economics and Law (Evans and Baxendale, 2008).

The first school of thought is represented by John Maynard Keynes and his followers from Cambridge-England (Joan Robinnson) and Cambridge-Massachusetts (Gregory Mankiew and Paul Krugman). The second one is also known as the Chicago school and is represented mainly by Milton Friedman, but also R.J. Lucas. The most important thinkers of the Austrian School of Economics who had important contributions in terms of crisis theory are Ludwig von Mises, Murray N. Rothbard, F.A. von Hayek.

The theories and explanations provided within the first two schools of thought and their versions (neokeynesist, post – keynesist, neoclassical theories), have practically dominated economic thought in 20th century and still dominate it. Keynesism and monetarism followers accept institutional arrangement in the monetary, financial and banking field: fractional reserves, the Central Bank with the role of lender of last resort and paper currency (Huerta de Soto, 2010).

Unlike these, the economists of the Austrian School of Economics have argued in the context of both 1929 and the present crisis, that at the base of crisis and economic cycles sit institutions and institutional arrangements such as fractional reserves and paper currency (fiat money) because they allow the artificial expansion of credit and money supply of the banks, causing serious imbalances in the capital structure and finally leading to severe financial and economic crisis.

From this perspective, the question of financial and economic crisis is much more serious, as the crisis of the last century genealogy and their magnitude occurs, mixed with the entire evolution of the global financial system and especially with its gradual nationalization, financial-banking system is one of the sectors most heavily nationalized and regulated (Rothbard, 2002). In the current crisis case, on the one hand keynesist-type approaches are in difficulty because aggregate demand, including raw materials and inputs (coached by the boom in the real estate sector and vehicles construction) was generally high and it cannot be said that a drop in aggregate demand has triggered the crisis, but rather, this decrease has occurred in the context of the crisis and was installed after triggering it. On the other hand, neither the monetary explanations have not been more successful, because inflation was generally under control.

So economists, investors and consultants, who predicted the current crisis, are part of another economic thinking, which has its roots in Austria of the 19th century, and for this reason is called the Austrian School of Law and Economics. According to Austrian theory, economic imbalances occur in conditions of unanticipated effects by the market actors, credit expansion, which leads to a lack of coordination at inter-temporal level of the production structure. In other words, credit expansion and creation of new trend and new fiduciary tools stimulates and feeds the artificial development of productive capacities of some sectors, either IT sector, real estate or financial securities market.

This explains the current economic crisis facing the global economy, the crisis that has often been defined, not only in the media, or by international organizations such as the International Monetary Fund (Hamilton and Quinlan, 2009) but also by economists such as Alan Greenspan as "crisis of the century". Its beginnings are somewhere in 2001 when the USA FED interest rate dropped by 1% to revive the USA economy, shaken by the September 11 attacks, but also economic relax after stunning era ".com", namely the development of Internet-related companies in 1995-2001.

The Federal Reserve System decreased the interest rate no less than 27 times between 2001 and 2003, and these low interest rates have facilitated rapid growth of loans.

Easing credit conditions led to a natural reaction of individuals, to access the easy loans hoping that they will have the opportunity to refinance them in more advantageous conditions.

Therefore many Americans abandoned rent in favour of buying their own property, since banking institutions had started to borrow money for purchase of houses, the so-called "subprime loans", so that, in 2006, the statistic revealed a quick ascent of houses prices, reaching 124% during the last decade (Montuschi, 2009). The climax seems to manifest itself only in the moment in which the major financial institutions have shown interest in purchasing public effects, starting from the premise of achieving significant profits, with a low risk, but no one at that time was not aware the danger they were exposed to (Johnson, 2009). Some examples are renowned institutions such as Morgan Stanley, Lehman Brothers, Goldman Sachs, which have been captured in this vicious circle.

Therefore, it all started in the banking system, which is the base of the entire American system, and these turbulences formed the basis of the financial crisis, destabilizing the world's markets.

2.EFFECTS OF THE CURRENT FINANCIAL CRISIS

The financial crisis through which we pass is unprecedented in post-war economic history. Triggered initially in the United States and generated by the chaos of country's financial system, the economic crisis has spread in Europe and, due to globalization, as a domino effect, it has spread throughout the world. Most countries of the world felt it, but mainly developed economies that have experienced a decrease or even stagnation in economic growth rate, and with rare exceptions, mild increases. Less affected states by the crisis are emerging economies, sometimes more loosely integrated into global capital markets, an example in this case being China, which has a capital market less integrated into global markets, without being fully liberalized.

The international financial and economic crisis has induced primarily distrust in financial institutions functionality of contemporary capitalism, had unavoidable adverse effects on global economic growth, interest rates and unemployment, devaluation of the national currency, increased current account deficits and public debt, and last but not least has created political, strategic and social problems.

In late summer of 2007 we talk about the first signs of acute instability among banks. A first consequence of current acute crisis is bankruptcy of banking and credit institutions of the United States and the European Union. It generated the mistrust that led to serious imbalances in the stock market, the value of the shares dropping at times so much, that it was necessary to suspend the stock transactions for a specific period of time.

Contrary to the principles of modern capitalism, most countries have nationalized a significant part of the financial system in a desire to prevent the bankruptcy of banks and other financial institutions. An example of this is the injection of 540 billion dollars by the FED in retirement funds and 700 trillions of dollars to banks and insurance companies threatened with bankruptcy. Likewise, England has granted £ 20 billion on loans made by banks for small and medium enterprises, and Germany 100 billion euros.

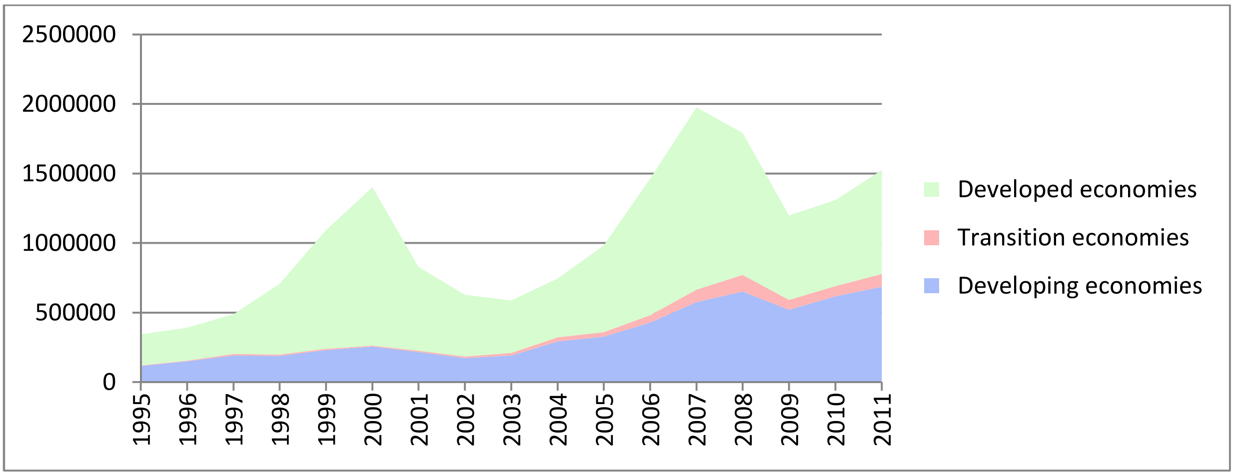
Another effect is the decrease of production in most European States such as Germany, England, France, Spain, and Italy and others. Even more, exports also decreased substantially as the fast pace of trademarks expansion in this decade has been drastically reduced. The global slowdown has reduced demand for consumer goods and industrial products, reducing earnings from exports. For example, in Russia due to decrease in price of crude oil export earnings have dropped substantially. Thus, world trade has experienced significant decreases, trade credit has become increasingly rare and more expensive, while industrial firms were left helpless in the face of declining demand.

By reducing the demand for consumer goods, a number of companies went bankrupt reducing the number of employees and wages.

The crisis has had a major negative effect on investment in emerging markets, portfolio investments dropping drastically. In addition, foreign capital inflows have been strongly affected by the financial crisis, the decline being considerable, especially in 2009.

Unfavourable financial and economic conditions have affected the transnational corporations from all regions of the world, which are constrained to reduce drastically the expenditure for investment, which has led to a strong rebound of FDI flows received or generated globally in 2008-2009.

Figure 1- Trends in FDI flows received globally and on major groups of economies in 1995-2010 -in million dollars-



Source: graph generated by author after UNCTAD database.

The powerful descendant trend of global FDI flows under the impact of the global crisis has put an end to the cycle of four years of uninterrupted growth of these flows, which culminated in 2007 with a historical level of more than 2,000 billion dollars. After a decline of 16% of FDI flows worldwide received in 2008, their volume crashed with a further 37% in 2009, reaching out to overcome value threshold of 1,000 billion dollars, as shown in the previous chart.

The volume of global FDI flows received has increased only marginally in 2010, respectively, with less than 1%, from 1114 billion dollars in 2009 at 1122 billion dollars in 2010.

The last monitoring report on investment activity at a global and regional level, published by UNCTAD, reveals that global FDI reached around $ 1.5 billion in 2011.

Therefore, the stagnation of investment activity at international level is a matter of serious concern, especially due to the fact that public investments and economic incentives packages initiated by the Governments of the world in order to combat the negative impact of the global economic and financial crisis are about to exhaust their effects, and private investments like FDI, representing the decisive prerequisites for economic growth and development have not yet resumed their role as starter of economic growth.

3. ASPECTS OF THE CRISIS IN SOUTH-EAST EUROPE

If on the one hand, by mid-2008, economies like the United States, United Kingdom, France, Germany, and Japan have already been affected by the economic crisis, on the other hand, the countries from South-Eastern Europe continued to grow. In the first eight months of 2008, those states have lived with the confidence that South-Eastern Europe will be immune to the crisis, but as of September 2008, the situation has changed notably for those countries.

The main channels of transmission of the crisis in South-Eastern Europe have been more indirect than direct and have included: international trade, foreign direct investment, monetary policy, and the remittances of migrant workers.

Regarding the effects of the crisis in this area, they were embodied in the decrease of the growth rate of gross domestic product and foreign direct investment flows, increasing inflation and the increase of the unemployment rate.

Thus, as regards to the rate increase of the gross domestic product, which fell significantly across the region, but can be seen from the table below that Romania has experienced since the end of 2008, early 2009, with the outbreak of the crisis in the region, the biggest decrease of 6.6%, closely followed by Croatia with 6%. Over the next three years the crisis shows that in general this indicator began to record a positive trend, with the exception of Greece, the only country in the region with a growth rate of negative GDP in 2012. However, the level of GDP is lower than pre-crisis, moreover is much dependent on international and European evolutions.

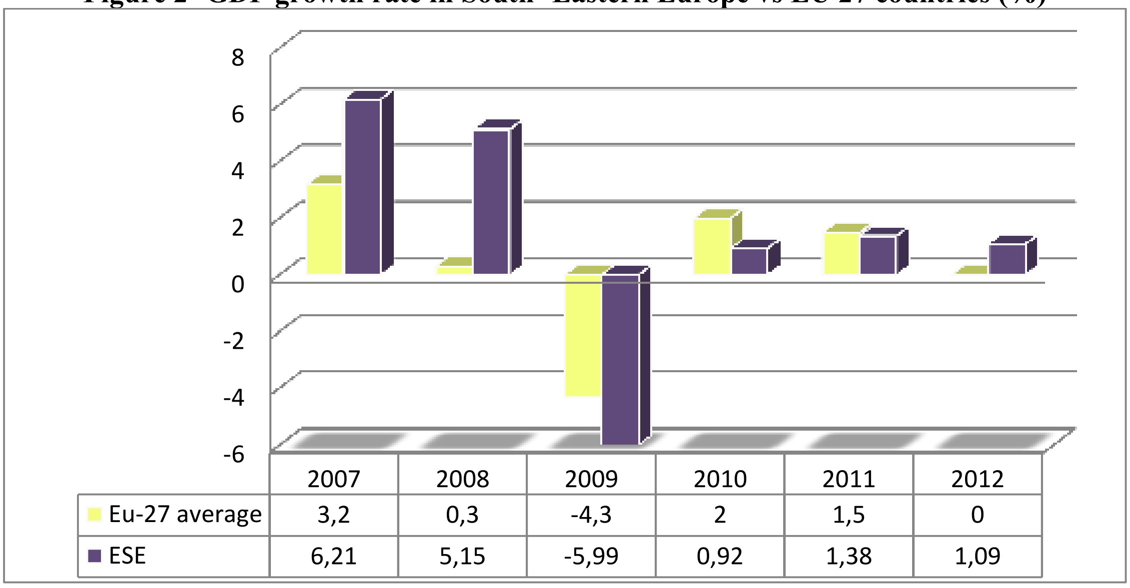
Table1- GDP real growth rates (%), 2007 – 2012

Country	2007	2008	2009	2010	2011	2012
Croatia	5,1	2,2	-6	-1,2	0,6	0,8
Macedonia	6,1	5	-0,9	1,8	3,1	1,8
Albania	6	7,7	3,3	5	1,8	1,2
Bosnia and Herzegovina	6,8	5,7	-3,1	0,8	1,8	0,5
Montenegro	10,7	6,9	-5,7	2,5	2	1,9
Serbia	5,4	3,8	-35	1	1,9	1,1
Romania	**6,3**	**7,3**	**-6,6**	**-1,6**	**2,5**	**1,6**
Bulgaria	6,4	6,2	-5,5	0,4	1,7	1,4
Greece	3	-0,2	-3,3	-3,5	-6,9	-4,4

* Estimations of World Bank
Source: computed by author after World Bank and Eurostat data.

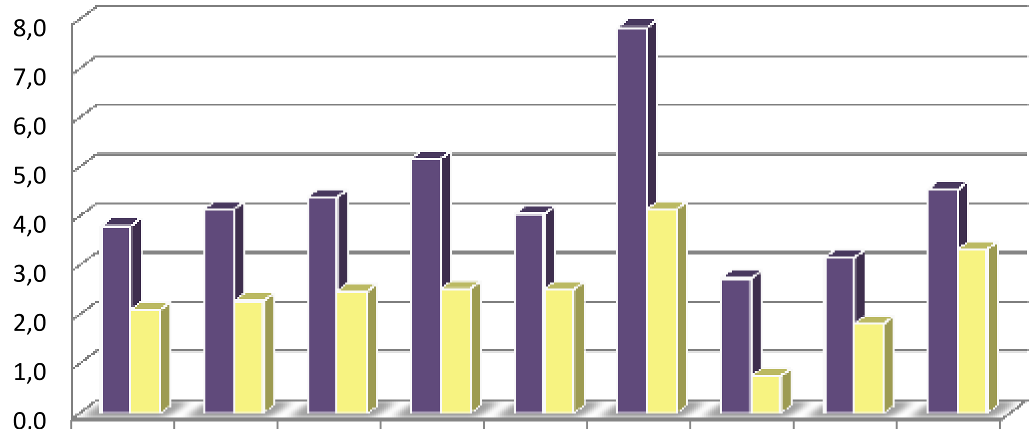
In order to highlight the impact of the crisis on one of the most important macroeconomic indicators we have conducted a comparative analysis of the increase rate in GDP between the average of Southeast Europe countries and the EU-27 average. Here it can be seen that the region of South-Eastern Europe felt the beginning of the crisis most powerful compared to the rest of Europe, a fact evidenced by the GDP growth rate, which has dropped dramatically in 2009 to 5.99%, as can be seen in the chart below.

Figure 2- GDP growth rate in South- Eastern Europe vs EU 27 countries (%)



Source: graph generated by author after World Bank and Eurostat data.

Figure 3- Annual inflation in South- Estern Europe vs EU 27 countries



	2003	2004	2005	2006	2007	2008	2009	2010	2011
ESE	3,8	4,2	4,4	5,2	4,0	7,8	2,7	3,2	4,5
UE 27	2,1	2,3	2,5	2,5	2,5	4,2	0,8	1,8	3,3

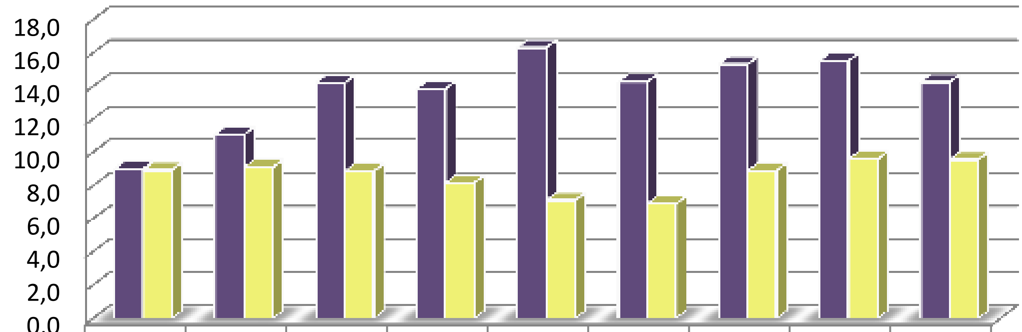
Source: graph generated by author after World Bank and Eurostat data.

In line with the GDP growth rate, annual average inflation is also significant. In the chart below you can see that, between 2003 and 2007, South-Eastern Europe recorded a rate of inflation cantered around 5%, but in 2008, inflation in the region has exploded, increasing by approximately 67% compared with the last year. For 2009, we can notice a noticeable difference between the EU-27 average of only 0.8% and the ESE average of 2.7%, maintaining the upward trend so far.

Another indicator worth considering is the unemployment rate. As was expected, the crisis repercussions on the labour market were felt both in the region and in the EU 27. Thereby we can see that since 2007 the unemployment rate in South-Eastern Europe began to increase significantly (16.3%).

The following years marked by crisis were unfavourable for the labour market, the average of the South East area regarding the unemployment rate was almost double compared to the EU 27 average, actually trained by countries like Greece within the Southeast region which in December 2012, record the highest rate of unemployment (26.4%).

Figure 3 - Unemployment rate in South - Eastern Europe vs EU 27 countries (%)



	2003	2004	2005	2006	2007	2008	2009	2010	2011
ESE	9,0	11,1	14,2	13,9	16,3	14,3	15,3	15,5	14,3
EU 27	8,9	9,1	8,9	8,2	7,1	6,9	8,9	9,6	9,6

Source: graph generated by author after World Bank and Eurostat data.

As regards to foreign direct investment, statistics indicate that in the region they were three times lower in 2011 (8.9 billion Euros) compared with 2008 (27.94 billion Euros) as result of the economic and financial crisis. This phenomenon explains the fact that in the years preceding the crisis, foreign direct investments have been concentrated only in certain sectors that were very vulnerable with the advent of the crisis.

Regarding investors in the South-Eastern Europe area, it should be noted that most of the direct foreign investments made here come from neighbouring European countries. An example in this case is Austria, which has invested in nearly all the countries of the region, with the exception of Macedonia, as regards the banking sector.

Table 2- FDI inflows (billion euro) for 2007-2011

Country	2007	2008	2009	2010	2011
Albania	0,481	0,665	0,696	0,831	0,65
Bosnia and Herzegovina	1,52	0,684	0,18	0,174	0,25
Bulgaria	9,052	6,728	2,437	1,779	1,064
Croatia	3,651	4,219	2,38	0,281	1,2
Macedonia	0,506	0,4	0,145	0,159	0,21
Montenegro	0,683	0,656	1,099	0,574	0,3
Romania	7,25	9,5	3,49	2,22	1,92
Greece	1,54	3,07	1,75	0,281	1,3
Serbia	2,513	2,018	1,41	1,003	2,01
Total	27,2	27,94	13,59	7,3	8,9

Source: WIIW – Vienna Institute for International Economic Studies, National Banks and UNCTAD, March 2012.

CONCLUSIONS

The analysis of the main economic and financial indicators shows that South-Eastern Europe countries have felt with a lag of about one year the joint effects of economic and financial crisis. But even so, the effects were stronger than in developed economies, and recovery from the economic recession was slower.

In the first place, 2009 brought the fall of the gross domestic product, due to the contracting demand in the EU 27 partners and foreign direct investment. The most affected countries were Romania and Croatia that have experienced the largest drop in GDP in 2009, -6.6% respectively -6%.

Secondly, South-East Europe recorded significant differences compared to the EU 27 in terms of inflation; for 2009 it can be seen that the average inflation in the EU 27 was only 0.8%, while the average for the region of South-East Europe was 2.7%.

Third, the crisis has brought with it a major issue in social and economic terms, namely unemployment. It has affected the whole Europe, but most of it was felt in the South-East Europe region, where the average unemployment rate is almost double compared to the EU 27 average.

Therefore, to overcome the effects of the current financial and economic crisis are necessary measures and structural reforms that will boost the competitiveness of the region. To achieve this, the South-East Europe should explore more creative potential at its disposal.

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