

THE UNITED STATES OF AMERICA AND THE CAUSES OF THE ECONOMIC CRISIS

Florin Alexandru LUCA, Mihai P. IRIMIA

Universitatea Tehnică „Gh.Asachi” Iași

În opinia noastră, apariția unui fenomen economic negativ de o asemenea amploare reprezintă, în primul rând, un semnal de atenționare pentru toți factorii de decizie. În prezentul articol vom încerca să conturăm câteva cauze și soluții imediate pentru a diminua efectele nemăsurate și nedorite ale acestui dezechilibru major. Printre cauzele principale ale acestui dezechilibru menționăm: scăderea peste așteptări a cererii de pe piața internă; reducerea creditului de investiții; dezechilibrul dintre economia reală și economia nominală; maximizarea profiturilor obținute de o minoritate; reducerea rolului statului în economie. Dacă se pleacă de la principalele cauze enunțate, soluțiile posibile anticriză pe termen mediu și scurt sunt: 1) restructurarea sistemului financiar actual; 2) evitarea repetării unor evenimente economice cu urmări grave pentru economiile naționale; 3) promovarea în continuare a investițiilor efectuate în infrastructură; 4) recorelarea sectorului financiar-nominal la cerințele dezvoltării economiei reale.

The causes of the present worldwide economic crisis can be tracked back to the U.S.A. and were signaled in a more insistent way from the middle of the year 2007. Such crisis is similar to the one that took place there in 1929-1933. It appeared as a financial unbalance on the mortgage loan market of this over-developed economy and then spread to the industrial sector, the world of business, the labor force market etc. and finally reached other countries due to a "domino effect". In 2008 we are dealing with a real worldwide economic crisis that affects most countries of the world including Romania. In our opinion, the present crisis showed its effects very quickly and compassed all areas of economic-social life. It is in fact an all-comprising middle term crisis, given that viable anti-crisis solutions will be applied.

This major unbalance is based on several causes that interweave one with each other due to certain **conditions** such as: in the first place, an area of effect much wider than in the case of the last crisis (1929-1933); in the second place the globalization conditions of markets, especially in favor of the developed countries; and in the third place, the intensity and amplitude of the economic-social effects, that will be known later.

If we refer to the present **causes** of the world economic crisis, these are indicated by the existence and intensity of the following amplitude phenomena:

a. The fall beyond expectations of the demand on the internal market due to the lack of incomes, concomitantly with the *reduction of investment credit* that had a disastrous effect on the individual households and enterprises, determining the decrease of work places etc.

b. The permanent emphasis of the *unbalance between real economy* (represented by the unjustified production, repartition, exchange and amplification of the credit consumption) *and the nominal economy*, determined by the inflation, interest rate growth, lack of prudence, exaggerated speculative operations, forced variations of the currency rate etc.

c. The maximization of the profits obtained by a minute minority, such as managers, directors, action holders, large multinational companies, banks, financial institutions etc., by using an unprecedented exaggeration of speculative operations.

d. The unjustified growth of the role of market, promoted with the help of the I.M.F. and the World Bank, and the systematic decrease of the role of the state in economy, fact that favored the accumulation of large malfunctions.

e. The lack of control on management strategies of multinational companies and the lack of control on swap-type speculative operations.

These are some of the causes that you might find in the U.S.A., a country that confronted a terrible unbalance from 2008. It is normal therefore that the U.S.A. is the most affected country in world economy and that it is facing the phantom of a large scale recession. From the theoretic and practical standpoints, the crisis takes place at the end of an important cycle of economic growth, fact that determined not only consistent advantages, but many financial problems as well, characterized by the acute lack of transparency and prudence of the bank financial sector and by a wrong analysis of mortgage market risk.

If we refer to the level of wages and salary incomes as the point of reference for national incomes, we might observe that it fell in 2006 to 51.6% compared to 1999, which is considered the lowest limit registered

from 1929. Correlated to wage reduction, the revenues of economic entities registered the largest profits in history. It is clear that inequalities have continued to accumulate and speed up, which leads to the fast decrease of the afferent part of salary remunerations in national incomes.

Most specialists consider that the present economic situation was generated by the mortgage loan crisis in the United States, which is considered the trigger of the general instability and, in fact, is nothing else but a symptom of the growing insolvency of individual households, where the middle indebted percent in 2007 reached almost 100% of the GDP (in the conditions where the savings percent was just 0.2% of the GDP). To this we could add the unnatural behavior of American politics regarding taxation, which protect the incomes of a very small privileged class.

The indebtedting of physical persons grew a lot as well, dissociating itself from the GDP evolution from 2002-2003. Still in 1993 the mortgage loan had the tendency of exceeding the non-mortgage loan. Thus households used directly the mortgage loan as a global financing source, basing themselves on the appreciation trend of the mortgaged real estate in the context of the generalized price growth in this sector. The mortgage loan system in the United States in fact allowed physical persons to exceed their credit limit with a new loan, if the real estate that is the object of the contract gained value since the contract was signed. Liquidities generated in different ways by such a real estate are called Home Equity Extraction (HEE).

At the same type, the appetite of banks and financial credit organizations for the growth of the indebtedting degree was sustained by: 1) real estate speculations (anticipation of the real estate value growth) and 2) the possibility to issue to these financial institutions CDS titles (credit default swap), which represent protection against risk. The financial liberalization on the American market allowed these financial institutions to offer more and more advantageous credits that in turn influenced the growth of the real estate sector. The real estate speculative bubble that kept inflating from 2002, allowed households to obtain new credits on the bases of real estate appreciation. In fact, the indebtedting degree of households was not decreasing, even though they were taking new loans, due to the fact that the value of owned goods was constantly reevaluated.

The impact of mortgage loan on American economic growth

	GDP real growth rate	HEE in the % of real consumption expenses	HEE Contribution to the economic growth reflected in the GDP	GDP growth rate recalculated without the HEE contribution
2002	1.6%	1.6%	1.1%	0.5%
2003	2.5%	1.9%	1.3%	1.2%
2004	3.6%	1.8%	1.2%	2.4%
2005	3.1%	2.4%	1.6%	1.5%
2006	2.9%	3.3%	2.2%	0.7%
2007	2.2%	3.3%	2.2%	0.0%

Source: US Bureau of Economic Analysis

Economic growth in the U.S.A. continued on the bases of a non-real consumption, guaranteed by credits. Therefore, mortgage indebtedting is the main source of consumption growth from 2000-2002. The HEE part in consumption expenses of households did not exceed 0.4% of the level of 1990. These figures grew brutally from 2002 and the mortgage loan played a determining role in the economic growth in the United States between 2002 and 2007 (cf. chart). U.S. economic growth was sustained thus by a „purely speculative” financial mechanism that got permanently involved, as an interaction between the real sphere of economy and the financial-nominal sphere, that became responsible for the outbreak of the crisis. The unbalance of the mortgage market is nothing but a permanent symptom and the growth of the last years was not sustainable.

The crisis of the mortgage market began in 2007, when more fragile households became insolvent from the economic standpoint and the banks based on this segment went bankrupt. Thus in the autumn of 2007 the crisis had already moved from the real estate market to the bank system, while U.S. financial supervision organizations proved to be reckless and incautious. Thus the crisis spread through several instruments and displaying the following tendencies.

First tendency of effects, observed in the beginning of 2008, displayed itself by credit contraction (credit-crunch) that affected both, individual households and companies, as follows:

- banks became vulnerable by accumulating in their balance toxic assets that came from the real estate sector, diminishing drastically the crediting volume;
- uncertainty regarding the accumulation of toxic assets in banks generated repositioning and withdrawal movements of bank funds, which lead to bank bankruptcy. The first took place in September 2008. Lehman Brothers kept on with a major lack of liquidities;
- the crisis became worse when on the interbank market financial institutions refused to grant credits one to each other.
- the unwished contraction of bank credit lead to compromising enterprise investments through the fall of the turnover fund, the decrease of production, reflected mainly at the stock exchange, the decrease of the financial indexes of companies that lead to their undercapitalization. From this stage up to mass dismissals and serial bankruptcies there was just a step. The crisis was transmitted from the nominal financial sector to the real one and vice versa. The continuous degradation of the economic activity led to chain-reaction insolvency of households, which in turn jeopardized the recovery of banks and insurance companies (mortgage loans were not reimbursed by those who were credited, as they became insolvent).

The second tendency, even though it is conjectural and affected only the first half of 2008, could be felt in the high prices of the oil barrel that diminished the financial resources of more fragile households. The U.S.A. is considered the largest oil in the world and often wastes in an unjustified manner important energy resources (4, 5 liters gasoline engines). The temporary price raise happened in the worst possible moment and diminished incomes.

However, the change of administration at the White House and the state involvement by applying an ambitious plan, seem to inverse the tendencies from December 2008. American Stock Exchanges ended the first session of the last week of March 2009 with a powerful growth after the United States Treasury Department, as coordinating bank, announced in the end of March 2009 a plan that will allot 1.000 billion dollars to buy toxic assets and support a heavily affected financial system. As a consequence, the American indexes show their most powerful appreciation from 1938 up today.

According to data at closing, the Dow Jones index recovered and raised by 6,8%, which means 7.775,86 points, the highest level of the last five weeks, while the S&P 500 index grew by 7,1%, which represents 822,92 points, the highest level of the last seven weeks. All the ten categories of industry that are part of the S&P 500 index registered significant growth as well. The American Public-Private Investments Program will use between 75 and 100 billion dollars from the Toxic Assets Removal Program, in value of 700 billion dollars, and will grant to the government the "purchase right" of such assets limited to 500 billion dollars. With time, the program will have the chance to get doubled – the same coordinating bank announced.

Simultaneously with the American recovery plan, we should not neglect the contribution of another powerful economy present on the world financial market, China, which wishes to profit fully from the opportunities generated by the crisis. Beijing announced it will continue to buy bonds of the American Treasury Department, where it is already considered as the main foreign creditor. On the other side, this country is ready and even asked to participate in the consolidation of the automobile and iron and steel markets, in such a way that powerful competitors will be created on global markets. We consider that in crisis situations wealth is created and accumulated according to new rules, while hierarchies change overnight. This fact is known also by the Chinese, who have the ambition and the necessary resources for such ascension. Even after it became the main foreign creditor of the U.S.A., China never stopped such negotiations. The Central Bank of China announced in Beijing that it will continue to buy bonds of the American Treasury Department, even though many Beijing officials expressed their concern about Chinese investments in the U.S.A.

U.S. President Barack Obama himself assured that they may have full confidence in the American economy. Chinese investments in bonds of the Treasury Department raised to almost 740 billion dollars in January 2009. The Vice-president of the Central Bank of the Popular Republic of China underlined that the present world crisis affected the growth rhythm of the currency reserves of that country. Though in China there were no flights of capital, unlike other emergent markets, the value of incomes was not as high as in the past years. We should mention that China currency reserves are presently the largest in the world, amounting to 1,950 billion dollars by the end of 2008. At the same time, China wants to consolidate its steel and car industries, very fragmented presently. The government negotiated and offered advantages for five steel producers and three large manufacturers from the automobile sector, in order to take a dominant position and enter in

competition on the global market. We should mention that this country with a huge human, economic and financial potential has over 100 car manufacturers and 700 iron and steel companies that for several years try to become a competitive global player.

A new impulse for the American market came from the surprising recovery of durable goods orders in February 2009. The Trade Ministry of the United States announced that the demand level for durable goods grew by 3.4% to 165,6 billion dollars, the biggest grow from December 2007.

The combined action of these factors, to which we should add the falling (favorable) prices of the oil barrel, indicated the first steps of the American economy. The American economy registered a 14580 billion dollars GDP (strong purchase parity) in 2008, which related to the population of the U.S.A. produce a GDP per capita (PPP) of 48.000 dollars, a much higher average than the one registered in the E.U. of approximately 34,000 dollars.

If we refer to the Romanian economy, we will observe that it passed through difficult moments, due to the devaluation of the national currency from 1 EUR = 3.5 RON (September 2008) to 1 EUR = 4.2 (February 2009) and the contraction of credits and demand in the real economy, which unfortunately coincided with a growing unemployment.

However, the fact of being an E.U. member and the support of international financial organizations gave a powerful support to the Romanian economy and did not allow it go to a descending trend, even though it suffered in the last year (2008) due to two important unbalances. One is the growth of the trade balance deficit, i.e. imports exceeded exports by much, and the other one is the unbalance that refers to the worsening of the budget deficit, which grew a lot in the last yeas. The year 2009 will be characterized all through by a negative economic growth, all this after the economy of Romania contracted by approximately 4% in the last trimester of 2008 in comparison with the previous trimester. In our opinion, the agreement signed by Romania and the I.M.F. present two particularities: 1. the large volume of allotted funds compared to the contribution to the funds of the world institution and 2. the maintenance of a partnership with commercial banks, where the main requirement will be that branches in Romania be properly capitalized by the mother banks in order to face the economic crisis.

We consider that the financial package amounting to approximately 20 billion euros (Romania will receive from the I.M.F. approximately 12.9 billion euros and from the European Commission 5 billion euros, the World Bank will credit Romania with 1 – 1.5 billion euros and it will receive from BERD up to one billion euros) will allow a gradual adjustment of deficit allowing Romania to adapt to the conditions necessary to become part of the euro zone. The agreement was concluded for a 24 months term and will protect Romania from financial turbulences. The money from the I.M.F. will be accessed only in case that the National Bank of Romania will deem this necessary. If things will go in the wished direction, then Romania will not need to withdraw all this money. The effects of this agreement were positively felt immediately on the interbank market, where the Romanian RON began an appreciation trend, though the recovery effort will last several years.

Departing from the main causes that generated the present economic crisis, the possible anti-crisis solution at middle and short term are: 1) to restructure the present financial system, which does not correspond anymore to new requirements of operation transparency and high prudence, which will lead to restricting speculative operations; 2) to prevent that such economic events with heavy consequences for the national economies will be repeated (e.g. the absolute power exercised by managers, directors and owners of American enterprises), an effort in which national institutions will get involved also for the correct evaluation of economies; 3) to continue promoting investments in infrastructure in order to create new jobs and diminish unemployment; 4) to re-correlate the financial-nominal sector to the development requests of the real economy.

Bibliography:

1. Adumitrăcesei I.D. Evenimente și personalități. Evocări. Vol.3. - Iasi: Noel, 2009, p.66.
2. Piketty T. and Saez E. How progressive is US Federal tax System? An Historical and International Perspective // CEPR Discussion Paper. - 2006. - No 5778.
3. Bernstein J., McNichol, E., Nicholas, A., Pulling Apart. A state-by-state Analysis of Income Trends, Center of Budget and Economic Policy, Washinton D.C., april 2008.
4. Bivens J. Globalization, American Wages and Inequality. Economic Policy Institute Working Paper, Washinton D.C., septembrie 2007.
5. NBR decembre 2008 Working Paper.

Prezentat la 01.04.2009