

Still the Opposite!

“Reality’s monochord constitution cannot be avoided due to the fact that Wealth is, in practice, the substitute of Power. Property is Power. Wealth is a problem of yield, while Power is a problem of property. The extended association goes in the same direction: the property is an individual’s problem, while Liberty can only find its solution in yield.”

The epistemic founding of Economics falls into misstep, on an ideatic path, with its object of study. There are two values which structure the theory responsible for this methodological fracture: yield and individualism. The extra-economical origin of the idea-generating sources has been fixed by The Enlightenment in mechanical physics, for yield, and in political philosophy for individualism. The path of knowledge in Economics was to be trodden by industrialism, seen as a technological system for the transformation of energy into mechanical work with a utilitarian destination, and for the creation of national states as machineries meant to administer the individual rights and freedoms.

Having technical support though, yield did not seem to relate to the social context; just like the state seen a supra-individual formula seemed neutral in regard to yield. What was about to transform the two elements into the determinants of the antinomic states of Economics was, on the one hand the idealization of Wealth and, on the other hand the materialization of Power, in the sense that the former becomes the substitute of the latter and vice-versa. Thus, yield has a non-economic goal – the control of Power, while the individual has a non-political goal – the control of Wealth.

The conversion of the goals is possible through a perverse way: Property is the basis of Liberty! The dissonance is dissimulated by the fraudulent equivalence of the values situated – through their meaning – in contexts which are non-equivalent either through causes or through effects. Wealth has, in this logic, individual righteousness, while Power validates its targets on the basis of Property.

Reality’s monochord constitution cannot be avoided due to the fact that Wealth is, in practice, the substitute of Power. Property is Power. Wealth is a problem of yield, while Power is a problem of property. The extended association goes in the same direction: the property is an individual’s problem, while Liberty can only find its solution in yield.

The deduction contradicts the expectation: the yield-driven individual has Wealth. The hard core still lies in the deductive detail: the absence of Property means the absence of Liberty. If a yield economy supports individual Liberty, the immediate assertion indicates that a free society is a political association of owners. Any statistic in history shows that such a thing is make-belief.

Otherwise, the universal access to property is seen as a political theme with no economic basis. Yield as a source of property nullifies the general value of individual liberty. If for millennia the structure of property has statistically limited the essence of

economic individualism, Wealth has executed a de facto reduction in the democratic eligibility of Power. Thus, Liberty only has a real sense when it refers to the individuals who own property. Resorting to yield Economics reduces society, while through individualism Wealth wields Power. That is why Democracy could only have been representative.

Yield is an economic variant of the law of progress interpreted as the multiplication of Wealth. In an explicit way the multiplication of wealth lead to concentration, which would mean the diminution of the access to Liberty. The correction which was resorted to due to strict reasons of political correctness presupposed the redistribution of Wealth into a certain proportion.

The wealth-state was a somewhat successful instrument. Its essential destination was to be a correction of the absolute conversion of Wealth into Power. The redistribution targeted the enlargement of the base of Liberty. Certainly, one special mission also took place, that of keeping safe from alteration the preeminence of the individual perspective on property, which was threatened by the ante-bellum failure of liberal politics and by the emergence of the communist experiment.

The attenuation of individualism in society by furthering the wealth-state was compensated by a surprising movement in the direction of the economic individualism of the post-bellum states, in the context of competition between the ideological systems. Economic individualism was subordinated to the political individualism of the state.

The architecture of post-bellum economy was the institutionalized effect of the individualism of the national states, on the pillars of the Bretton Woods construction. The states defined the degrees of access to economic liberty not only within, but also in the international economy. The rich states were truly free.

Wealth remained the basis of Liberty in the new situation as well. The free states have provided the package for the control of global Wealth.

The worldwide concentration of Wealth has conserved the dependency. Liberty has a hierarchy built by Wealth. The global Power has economic determination sustained by the ethos of liberty impregnated by yield and sublimated individualism.

QED: the global world is exactly opposite!

Marin Dinu

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Basel III – Between Global Thinking and Local Acting

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Abstract. *The financial crisis has demonstrated that self-regulation is not sufficient to markets and financial institutions with systemic importance.*

Permissive regulatory policies, allowing the development speed of global banking financial system, have played an important role in emphasizing the upward slope of the financial crisis.

The new regulations known as Basel III framework aimed the strengthening of prudential capital and liquidity of financial institutions and create a stronger banking and financial system more resilient to shocks.

Basel III is trying to eliminate the shortcomings of Basel II, by more extensive rules on integrated risk management in banking and financial environment.

Keywords: liquidity; capital; systemic risk; financial stability; prudence; banking; crisis.

JEL Codes: G01, G21.

REL Codes: 11B, 11C.

The new set of regulations known as Basel III, approaches in an integrated manner the risks issue and its complexity, focusing on aspects that were highlighted by the actual financial crisis, with clear role for gradual implementation and performance and value creation added to the whole banking and financial system. The new provisions establish core capital ratio to 4.5%, double of the current level of 2%, plus a liquidity surplus of 2.5%. We appreciate that capitalized banks will fit in a buffer of liquidity, but will be new approaches for payment of dividends and bonuses. The new rules will be implemented from January 2013 and it is estimated that the process will end by January 2019.

Reforms target

- Micro-prudentiality, which will help increase the resilience of individual banks in times of stress;
- Macro-prudentiality, system wide risks that can develop in the banking sector and cyclical amplification of these risks over time.

Micro-prudentiality vs. Macro-prudentiality

Micro-prudentiality policies are those directed to insure health of individual financial institutions. Micro-prudentiality reform focuses on risk control in an intermediate frame, reducing but not eliminating the possibility of failure.

Regulatory instruments may be similar when it comes to micro and macro prudentiality, but macro-prudentiality policy applies them differently. For example, regulatory capital requirements would increase the contribution to systemic risk. This contribution depends on the intermediate interconnection and on the risks level translated into institutions' balance sheet risk, and is often correlated with size. To be effective in limiting the systemic threats, a surcharge of regulatory capital will probably increase more than proportionally the likelihood of systemic risk.

To counteract systemic risk, prudential regulators also may require pro-cyclical capital requirements. Thus, capital requirements would increase to create a capital buffer against adverse shocks.

Basel III highlights new aspects of integrated risk management banking, in a global regulatory framework, but with significant local impact over the banks' strength to shock waves. It addresses in a comprehensive manner risks generated by capital market transactions but also the capital diversification and its quality issues, in order to cover risks not sufficiently considered in the previous agreement or inefficient covered by capital requirements.

Some important indicators were reconfigured:

- *Liquidity coverage ratio* was lowered: the run-off⁽¹⁾ rate was reduced, and available funding period for long term lending rate (net stable funding ratio)⁽²⁾ was extended.
- *Leverage ratio*: the minimum required considered adequately is 3%. Multiplier effects will be monitored over four years, starting in January 2013, and new regulations will be implemented in January 2018.
- *Tier1 capital ratio*: less stringent rules for exclusion, intangible assets (e.g. software) and deferred tax assets (net DTA) were removed from the list of exclusions of the based capital ratio required; deferred tax assets (net) and investments in shares of financial institutions (the limit is 10% of component shares of the bank) were partially reintroduced.
- *Gradual introduction period* is about eight years. Application of new rules on liquidity coverage ratio and leverage will begin in January 2018.

Regarding liquidity, Basel III objectives are clearly formulated: to increase the liquid assets proportion held by banks and to reduce short-term financing. These objectives will cause banks to stop using models adopted from 1970-1980, when the models for the management of liabilities were implemented. New models of asset management will be adopted, so the size of the balance sheet will be determined by all financial resources that the bank may increase (liabilities), and the total assets will be adjusted to match available liabilities. Thus, a macro-prudential⁽³⁾ policy is implemented.

Banks will be forced to Tier1 capital rate from 2% to 7% in 2019. This report is a good measure against potential losses for banks. Under this interpretation of the new Basel III, there are different arguments for implementation in the banking community.

Below we highlight a few elements that can be interpreted as a response to the Basel III, given by banks and by regulatory authorities.

1. Capital

One of the new requirements of Basel III is the restructuring of the capital levels that banks use to solve the problem of minimizing possible losses.

2. Bail-ins

Bail-ins⁽⁴⁾ are a direct response of Basel III to the credit crisis and must be regarded as a gap, before a bank to be rescued by authorities/taxpayers, by liquidity injection. Reducing funding for short-term loans, in close agreement

with attracting deposits to reduce capital inadequacies, tends to be significant and may actually represent a physical correction of bank balance.

Basel III capital adequacy approach stems from the fact that, in the past, the stability of banks was generally measured only at the expense of capital levels and divides into the categories of risk assets weighted. We believe that banks that failed in the credit crisis may have had, no doubt, capital issues, but inevitably blocking was generated by the funding difficulties and also by liquidity problems.

3. Impact on market

The concentration of liquid assets of the commercial banks in government securities, the resultant of Basel III agreement, may lead to some disturbance in the economy. A solution would be to increase the possibility of banks to create liquid assets from other sources also, such as, for example, bills of exchange or other debt instruments.

Banks need liquidity sources that allow them to adjust their cash flow fluctuations, according to requirements. Before the financial crisis, a large proportion of liquidity came from unsecured deposits from the interbank market, but this is less likely to provide the liquidity needed in future. Since the beginning of the financial crisis, central banks deposits have become the main source of liquidity.

Considering the requirements for financial stability, possible liquidity crisis will have to be approached on integrated basis, by authorities reducing of the minimum rate of liquid assets, so that liquidity may be put into circulation and by central banks buying of a wide variety of eligible assets/extension of the collateral mix used.

Models that can be applied in the context of Basel III

When asked What impact may Basel III requirements have on performance and economic fluctuations?, in order to give an answer, some can use the tools of quantitative analysis. The methodology is based on appropriate scenarios of macroeconomic models. In essence, a version of a given scenario of new regulations is introduced in a model, entering input data and parameters and interpreting results, the equilibrium values (mean or mathematical expectation) and volatility (standard deviation) of macroeconomic variables.

The most used models are the DSGE type (Dynamic Stochastic General Equilibrium). They are used due to the fact that they are the only hypothetical experiments (based on scenarios) allowing to be performed in a consistent

manner. The VECM type models (Vector Error Correction Models) or “semi-structural” can be used, but they can give a concise answer only about economic performance and not on the fluctuations in the economy. In the DSGE model type, bank balance and credit markets are modeled explicitly. Thus, it creates a unified framework to analyze how it affects capital requirements and bank liquidity conditions (spread and loan) and finally output. Moreover, the effects of policy change can be studied not only on the equilibrium value of economic variables, but also on long-term variability.

Basically, we consider that three basic elements have changed in the new economic framework assumed by Basel III: increasing the minimum rate of capital, increasing the quality of the capital and liquidity requirements are more stringent. To quantify the impact of Basel III will have on performance and economic fluctuations, the three changes are required to be entered into a macroeconomic valid model. It should be considered that some models do not provide a characterization of bank liquidity or capital, or both. Moreover, even if the models would provide information about liquidity or capital, they are usually estimated or calibrated based rather on capital size than the TIER1 capitalization level specified in Basel III agreement.

Impact on the variability of output is determined using all type DSGE models. Basel III has introduced new rules on capital counter-cyclical requirements. To assess the effects of introducing a buffer to economic variability, we use models that take into account bank capital and capital requirements according to the dynamics of a key macroeconomic variables. Let's consider the dynamic system:

$$u_t = (1-\rho_u)\bar{u} + (1-\rho_u)\chi_u \times X_t + \rho_u \times u_{t-1}$$

where

u_t is targeted capital ratio at different times, $\bar{u}$ is the equilibrium rate of capital. We define X_t as part of long-term credit report/income. u_t 's changes when X_t changes are given by the sensitivity parameter $\chi_u > 0$. Parameter values are chosen ad hoc. In particular, set $\rho_u = 0.9$. Values of χ_u specific to the model we choose so as to produce reasonable changes of u_t around his $\bar{u}$: a rate of $\pm 2\%$ is considered reasonable. This is broadly in line with the level of 0 to 2.5% announced by the regulatory authorities for countercyclical capital buffers (Wellink, 2010, BCBS, 2010). Once the above equation is introduced in the model, unconditioned variances can be calculated and they may compared with the values recorded in the basic version of the model.

Models to quantify the EAD

As the new Basel III is also a response to financial crisis of 2008, and as one of the factors that have brought the crisis was entered in default of debtors (EAD, Exposure-of-Default), we analyze the a model to quantify the risk of EAD.

By Basel II agreement, banks were given two options to evaluate the necessary capital. The first is the standard approach, similar to that used in the Basel I, but the weights used are refined, provided by rating agencies. The second one is the approach based on internal ratings (IRB, Internal Rating Based), which allows banks to calculate capital requirements on their own methods. There are two sub-cases. First, the bank can calculate the probability of default (PD), but losses when counterparty goes bankrupt (LGD) are provided by experienced agencies (basic methodology). The second is the advanced methodology, which allows banks to calculate both PD and LGD.

Unlike Basel I, Basel II refers to market risk (related to the uncertainty of future revenue due to changes of prices and effects of various market rates). Against this, Basel II proposed VaR, completed with IRB methods.

With the new provisions, we consider that Basel III may improve VaR method. The main purpose is to increase capital reserves against counterparty credit risk, to reduce pro-cyclical trends and to provide incentives to move OTC derivatives market on the standard market, in order to reduce systemic risk on financial markets. Meeting these requirements requires more capital to the banks and thus increases the confidence level of banks' own economic capital models. The Basel III will be a stress test on the VaR, which will be calculated during the last financial crisis, which will increase the risk coefficients used by banks internal models to determine counterparty credit risk. Basel III extends the risk margin period from 10 days to 20 days for expected potential exposure to OTC derivatives. Incremental risk⁽⁵⁾ is calculated using the banking methodology, with a time horizon of less than one year, with 99.7% confidence level.

Risk measurement using VaR

This method is probably the most often used in financial institutions. VaR measures the risk of having a portfolio of risk assets for a period of time, Δ . The idea of VaR is to introduce confidence intervals in the equation and to define the maximum loss that will not be exceeded, with a high probability. However, the VaR results are sometimes interpreted too precisely, which may harm. Model's risk is inherent in risk management models. This risk occurs when the

model is not specified correctly or when some of the basic assumptions are not true. To determine the economic capital, used to estimate VaR, it requires a high level of trust, which causes the risk of the model. VaR disregards market liquidity. A market is liquid if an investor can sell and buy a large quantity of securities in a short time without the price to be affected. Modeling the effects of a illiquid market is extremely difficult. The transition from liquid to the illiquid market is considered as part of market risk (Embrechts et al., 2005, p. 40).

Specific to Basel I is current exposure method, based on VaR methodology. More important for the calculation of EAD are standardized methods (Standardized Models-SM), used by banks that did not meet the requirements to calculate the derivative exposure by themselves, but wanted a greater risk sensitivity than that provided by VaR.

Exposure is calculated using the formula:

$$EAD = \beta \times \max[CE, \sum_j RP_j \times CCF_j]$$

where

CE (current exposure) is the market value after reduction and compensation of guarantees, NRP are absolute values of net portfolio risk hedging and CCF are the credit conversion factors applied to these open positions. β factor is fixed by the authorities to 1.4 and is used as a reserve for potential extra-economic crisis and cover model risk. Standard models incorporate many of the key features offered by internal models method (IMM). Banks may choose to use their EAD calculation model at different times. SME is the most sensitive approach for calculating EAD risk, the work frame required under the Basel III (Gregory, 2010, p. 319). Exposure before the bankruptcy of the debtor, by SME, is:

$$EAD = \alpha \times EPE_{actual}$$

where

α is a multiplier set by the Basel III agreement and EPE actual is the actual expected positive exposure. α is a coefficient of correlation between market and credit risk, credit portfolio assumptions, concentration risk and model risk.

SMEs have many advantages over non-internal methods. For example, it determines an average exposure and not necessarily that all transactions have the same maturity. In addition, keep in mind that the basic market factors, hence the value of derivatives, are not perfectly correlated, arguing the benefits of diversification. It should be also considered the transactions performed in opposite direction, eliminating the problem of double counting.

Conclusions

The reform of counterparty risk in accordance with Basel III is specifically designed to improve systemic risk. This reform is a response to financial crisis of 2008. The regulatory framework agreed globally has significant influence within the activity of local banks and hence the local economies. Banks are in a complex exercise for making strategic decisions regarding the compliance policies and thus adapting to the customer segments and to the specific operations. However, proactive involvement of regulatory authorities in the acceptance liquidity coverage rate, including asset classes, might establish a formula widely accepted by financial markets banking.

However, even with this new framework aimed to increase liquidity, to improve the quality of capital to cover risks, the integrated risk approach can not exclude the future emergence of other classes of vulnerabilities in the financial and banking systems.

Notes

- (1) Run-off - Monitoring index of attracted sources.
- (2) Net stable funding ration – index that calculates the proportion of financed long-term assets.
- (3) Macro-prudentiality, used as a concept for the first time in 1978 by Cooke Committee.
- (4) Bail-ins - process in which corporate bonds can not be converted in equity.
- (5) Incremental risk includes the risk of default and migration risk for securitized credit products.

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Recovery of the Tourism Potential of the Central Development Region. Case Study

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Abstract. *Since the Central Development Region is not addressed in this paper as an independent tourist destination, the analysis performed at this level is meant to convey an overview of the recovery of the existing tourist potential across this regional structure. The results obtained can be compared with those of similar analyzes in the other regions of Romania and the European Union. Information obtained is necessary to adopt tourism development policies and strategies at regional level to develop each region.*

Keywords: tourism potential; the Central Development Region; the turistic accommodation capacity; arrivals; overnight stays.

JEL Codes: M31, L83.

REL Code: 14F.

1. Introduction

In tourism, a favourable premise is represented by its environment. Landscape, forests, lakes, monuments of art and architecture, historical sites, mineral waters are components of the environment.

The more diverse and unaltered are the resources, the higher is the attraction, answering to the various tourist motivations (Albu, 2005, p. 134).

The structure of the tourism potential of any country consists of natural tourism potential and anthropogenic tourism potential. The complexity of the natural tourism potential and attractiveness are correlated with features of relief and climate (Niță, Niță, 2008, p. 61).

The anthropogenic tourism potential of tourist destinations account for human creation over time, resulting in elements of cultural, historical, artistic and civilization, technical and economic, social and demographic elements which by their characteristics attract the streams of tourists (Stănciulescu, Micu, 2009, p. 73).

Consequently⁽¹⁾, tourism potential can be defined as all elements representing tourist attractions and which are suitable for arrangements for visiting and receipt of tourists. A country, region or zone's tourism potential is a prerequisite for tourism development. The essential requirement is that this potential is better exploited through the offer of product and tourism services suppliers.

A detailed analysis of the recovery process of Romania's tourism potential exceeds, by the scale, the limits of this paper. Methodologically, it is considered that by restricting the analysis area to one of the eight Romanian development regions can afford knowledge of the basic elements that characterize the complex process of recovery of the tourism potential. The results of this analysis extended to the six counties that make up the Central Development Region may have a certain level of representation to the extent that this overall development as expressed by its GDP per inhabitant ranks third in order of size of the eight regions. Also, issues of representation are highlighted by existing popular tourist destinations in the counties of Brasov, Sibiu, Mures, Alba, Covasna and Harghita.

The degree of recovery of the existing tourism potential in the Central Development Region can be expressed, as evolution in time, using the levels and dynamics achieved by the main indices characterizing tourist services.

2. Recovery of tourism potential in the counties within the Central Development Region

Consisting of six counties – Alba, Brasov, Covasna, Harghita, Mures, Sibiu - Central Development Region is characterized by a rich natural and human tourism potential. The most important features of the Central Development Region are related to landscape, ethnic, cultural and religious diversity. Physical and geographical features and cultural heritage reflects a great tourism potential of the Central Development Region. This natural and anthropogenic tourism potential allows the application of diverse forms of tourism that have specific forms of expression from county to county.

However, the recovery degree of the tourism potential for each county is different, as it is influenced by multiple factors, including: the uptake of tourist marketing concept by each entity in the tourism industry, the effectiveness of tourism marketing policies and strategies developed and implemented for each of the factors involved in tourism development, state involvement degree in tourism development, financial support coming from the European Union, and many others.

With each county of the Central Development Region, the results of tourism potential recovery process is as follows:

2.1. Recovery of the tourism potential of Alba County

The recovery of county's tourism potentials can be expressed synthetically through next statistical indices: touristic accommodation capacity, arrivals and overnight stays. The table below renders the evolution of these indices between 2000-2010.

Table 1

Touristic accommodation capacity and activity in Alba County

Years	Touristic accommodation capacity				Arrivals (thou)	%*	Overnight stays (thou)	%*
	Existing (places)	%*	Operational (thou places-days)	%*				
2000	1,641	100	484.9	100	49.3	100	86.2	100
2001	1,584	96.5	505.1	104.2	59.9	121.5	95.7	111.0
2002	1,559	95.0	418.9	86.4	48.6	98.6	95.3	110.6
2003	1,397	85.1	401.0	82.7	52.4	106.3	98.5	114.3
2004	1,276	77.8	377.0	77.7	48.2	97.8	90.1	104.5
2005	1,179	71.8	362.0	74.7	49.0	99.4	94.6	109.7
2006	1,544	94.1	489.4	100.9	50.6	102.6	103.2	119.7
2007	1,830	111.5	558.8	115.2	54.1	109.7	117.7	136.5
2008	1,828	111.4	588.6	121.4	51.3	104.1	111.1	128.9
2009	2,137	130.2	627.8	129.5	44.3	89.9	100.8	116.9
2010	2,109	128.5	619.5	127.8	47.8	97.0	101.1	117.3

Source: <https://statistici.insse.ro/shop/>

* These percentage data represent reductions (-) or increases (+) as compared to the base year (2000 = 100.0)

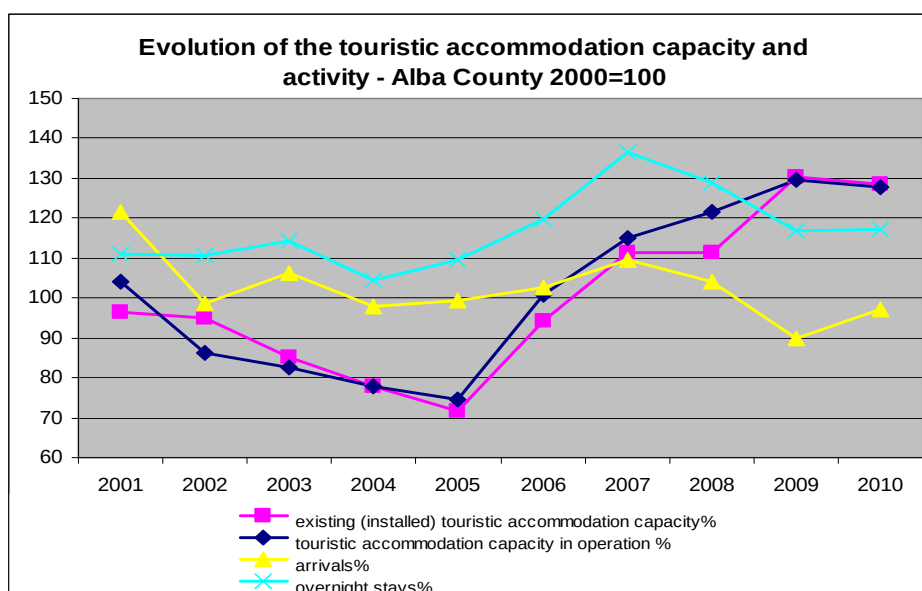
The index of existing touristic accommodation capacity in Alba County recorded, in 2005, the lowest value of the 2000 - 2010 analysis period, representing only 71.8% of the existing level in 2000. After this involution recorded over five years, an important increase is noticed so that in 2010 the existing tourist accommodation capacity was 28.5% higher as compared with 2000.

The index of touristic accommodation capacity in operation followed a similar evolution to that existing touristic accommodation capacity and in 2010 was higher by 27.8%.

Tourist arrivals in this county has seen fluctuations during 2000-2010, almost from year to year. In 2009 and 2010 arrivals, just like the number of tourists, were lower than in 2000. The highest level of arrivals was reached in 2001 and subsequently has not been equalled. This is not likely to show positive results on the recovery of the existing potential.

With the overnight stays index, in 2004 the lowest values were recorded while the highest values were recorded in 2007, representing an increase of 136.5% as compared to the base year 2000. In the past two years, the number of overnight stays decreased as compared to the previous year.

A representation of these evolutions is given in the following chart:

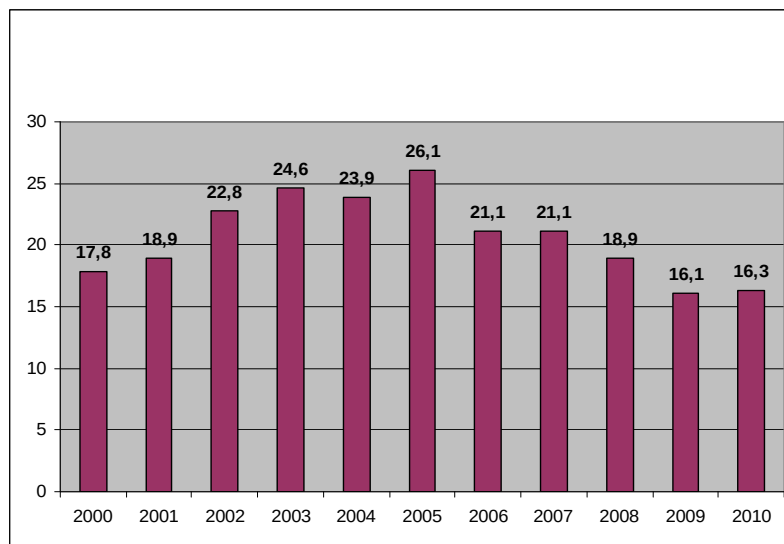


Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 1. Touristic accommodation capacity and activity - Alba County

In Alba County, between existing touristic accommodation capacity and touristic accommodation capacity in operation indices a high distance can be observed only in 2008, which leads to the conclusion that there are no significant differences between the number of touristic accommodation places recorded in the last reception of touristic accommodation structures and the number of beds made available to tourists by touristic reception structures. However, discrepancies between tourist traffic indices are more apparent, so arrivals and overnight stays have evolved differently.

The index of net using the touristic accommodation capacity in operation in Alba County during 2000-2010 showed the following developments:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 2. *Indices of net using the touristic accommodation capacity in operation (%) - Alba County*

The chart above shows that the indices of net using the touristic accommodation capacity reached its maximum level in 2005, and the minimum level in 2009. However, the levels of this index are very low, which indicates wide discrepancies between the offer and solvent demand. The pull of tourists to tourism destinations in the county is low.

Based on the developments showed by the data and figures above, we may conclude that there are severe limitations of existing potential recovery

process, since the developments of recent years do not differ from those in the early 2000s and in some cases such as tourist arrivals, they are even lower.

2.2. Recovery of tourism potential of Brasov County

Evolution of the main statistical indices which enables knowledge of the degree of exploitation of tourism potential of Brasov County is given by the following table:

Table 2

Touristic accommodation capacity and activity in Brasov County

Years	Touristic accommodation capacity				Arrivals (thou)	%*	Overnight stays (thou)	%*
	Existing (places)	%*	Operational (thou places-days)	%*				
2000	10,549	100	3,681.9	100	326.4	100	890.7	100
2001	10,276	97.4	3,670.3	99.7	328.3	100.6	884.6	99.3
2002	9,528	90.3	3,297.1	89.5	290.3	88.9	779.3	87.5
2003	9,611	91.1	3,649.9	99.1	324.8	99.5	823.3	92.4
2004	11,380	107.9	3,900.5	105.9	421.8	129.2	960.8	107.9
2005	12,037	114.1	4,219.5	114.6	448.1	137.3	1,000.3	112.3
2006	13,883	131.6	4,527.3	123.0	484.0	148.3	1,054.9	118.4
2007	12,634	119.8	4,704.7	127.8	556.8	170.6	1,191.5	133.8
2008	15,729	149.1	4,907.8	133.3	582.0	178.3	1,279.6	143.7
2009	14,728	139.6	5,034.8	136.7	451.7	138.4	985.0	110.6
2010	16,742	158.7	5,341.6	145.1	510.2	156.6	1,078.3	121.1

Source: <https://statistici.insse.ro/shop/>

*These percentage data represent reductions (-) or increases (+) as compared to the base year (2000 = 100.0)

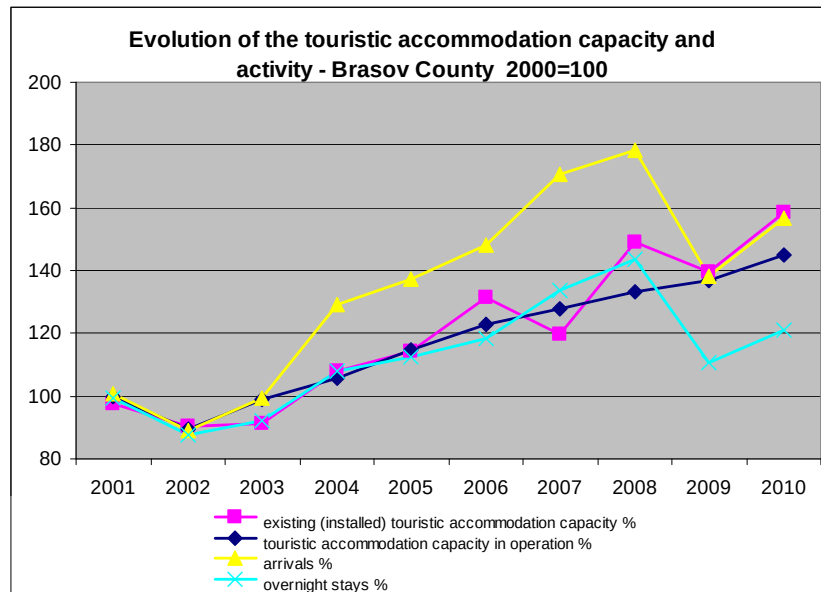
Existing touristic accommodation capacity has increased in 2010 as compared to the values recorded in 2000, by 58.7%, the most significant growth as compared to the other counties. This correlates with the overall development degree of the Brasov County, which is superior to the other counties.

With the index of touristic accommodation capacity in operation a continuous positive growth was also recorded in the period 2003-2010. The highest values were recorded in 2010, i.e. an increase of 45.1% as compared to 2000. The evolution of this index also reveals remarkable results on the recovery of the existing tourist potential.

The number of tourists who visited Brasov County peaked in 2008, reaching 582.0 thousand, the increase by 78.3% higher as compared to 2000. In 2010 there was an increase in tourist arrivals, meaning an increase of 13.0% compared with 2009 and substantial increase equal to 56.6% as compared to 2000. However, in this case the effects of the economic crisis can be seen too, as in 2009 and 2010 the levels recorded in 2008 could not be equalled.

In the case of overnight stays index too, a positive development was recorded, too, but the overall increase was less pronounced, by only 21.1%, which reflects the same trend of reducing the average duration of the travel.

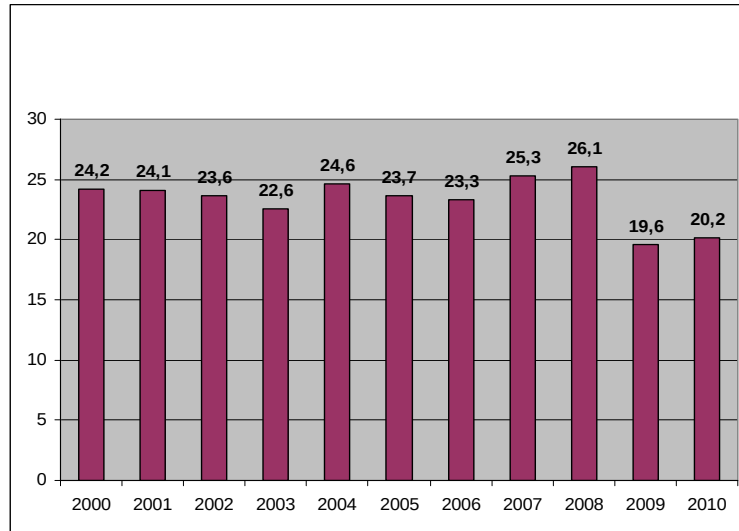
The chart below is suggestive for the above.



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 3. *Touristic accommodation capacity and activity - Brasov County*

The figure above clearly shows significant developments, of the main indices of tourism in Brasov County. One can see that the effects of the crisis were felt in the short term, in 2009, since in 2010 the results were higher as compared to the previous year, indicating a new upward trend. With respect to the evolution of the indices of net using the touristic accommodation capacity in operation the following figure is illustrative:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 4. *Indices of net using the touristic accommodation capacity in operation (%) – Braşov County*

The data above reflects a low level of net using of accommodation capacities in operation, with small variations from one year to another and a significant reduction in 2009 and 2010 as compared to 2008.

One of the causes that generate this situation is the emergence of a discrepancy between supply and demand. Brasov tourist market has more providers of tourism services while the demand for these services was limited by many factors, to which the negative effects of the economic crisis added in recent years. The levels reached by this index reflects serious unused resources of the existing potential as utilization of existing accommodation capacity.

One can conclude that the positive evolutions of the tourism activity results, except for the lower using levels of accommodation capacity in operation, prove that in Brasov County a positive trend is recorded in terms of better exploitation of existing tourism potential.

Note that the positive results mentioned are due to the tourist offers considered as good or very good in relation to the components of the existing natural and human potential. In this respect, some studies (Albu, 2007, pp. 110-112) show that Poiana Brasov destination has a very good tourist offer, the degree of attractiveness determined based on factors specific to this resort expressed in points is 296. For comparison purposes, the attractiveness of Predeal tourist destination was estimated at 182 points, while that of a foreign destination such

as Cortina D'Ampezzo to 490 points. The same researches show that Bran - Piatra Craiului area and Săcele-Bunloc-Piatra Mare area have a tourist offer which is considered to be good.

2.3. Recovery of tourist potential of Covasna County

The evolution of specific indices of tourism services in Covasna County is as follows:

Table 3

Touristic accommodation capacity and activity in Covasna County

Years	Touristic accommodation capacity				Arrivals (thou)	%*	Overnight stays (thou)	%*
	Existing (places)	%*	Operational (thou places-days)	%*				
2000	3,541	100	1,046.6	100	67.8	100	489.6	100
2001	3,571	100.8	1,042.0	99.6	66.5	98.1	541.2	110.5
2002	3,940	111.3	1,029.6	98.4	61.1	90.1	487.3	99.5
2003	3,929	111.0	1,048.3	100.2	62.7	92.5	519.6	106.1
2004	4,000	113.0	1,030.3	98.4	61.5	90.7	492.7	100.6
2005	3,664	103.5	976.9	93.3	54.0	79.6	490.9	100.3
2006	3,735	105.9	803.5	76.8	51.4	75.8	457.7	93.5
2007	2,592	73.2	766.5	73.2	52.5	77.4	429.0	87.6
2008	2,832	80.0	869.2	83.0	62.6	92.3	486.8	99.4
2009	3,293	93.0	939.1	89.7	62.4	92.0	452.0	92.3
2010	3,638	102.7	962.6	92.0	60.9	89.8	409.2	83.6

Source: <https://statistici.insse.ro/shop/>

* These percentage data represent reductions (-) or increases (+) as compared to the base year (2000 = 100.0)

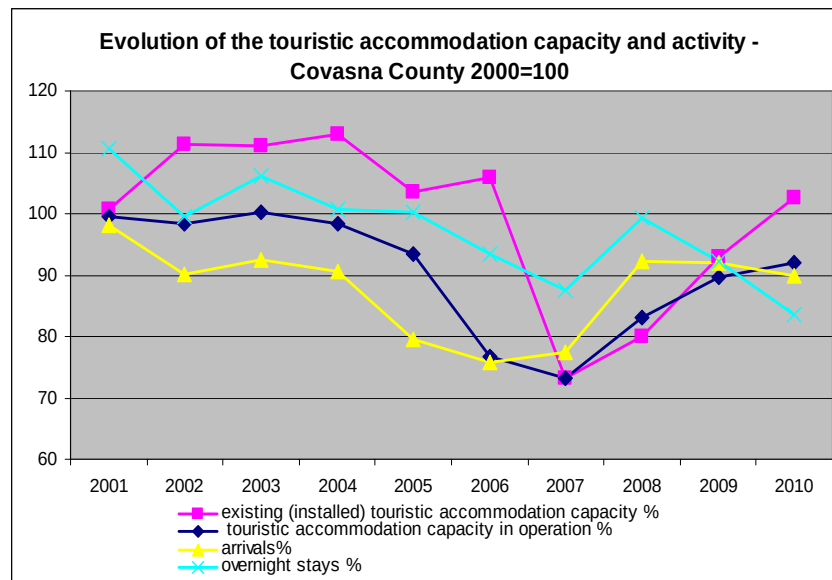
The existing touristic accommodation capacity in Covasna County recorded during 2000-2010 contradictory developments: it increased until 2004, declined until 2007 and then increased again. As compared to 2000, the growth recorded in 2010 was insignificant, only by 2.7%.

The touristic accommodation capacity in operation was below the level in 2000, all the time. It was less than by 8% in 2010 as compared to 2000. It is clear that such developments may not indicate positive achievements in terms of exploitation of existing resources.

Tourist traffic indices also experienced important negative developments with small fluctuations throughout the period considered. This tourist arrivals continuously fell up to 75.8% in 2006 as compared to 2000, they increased until 2009 and declined in 2010.

With the overnight stays index, there were fluctuations every year, but what can be seen as a negative development is that in 2010 a decline by 16.4% was recorded as compared with 2000 and by 9.5% as compared to 2009.

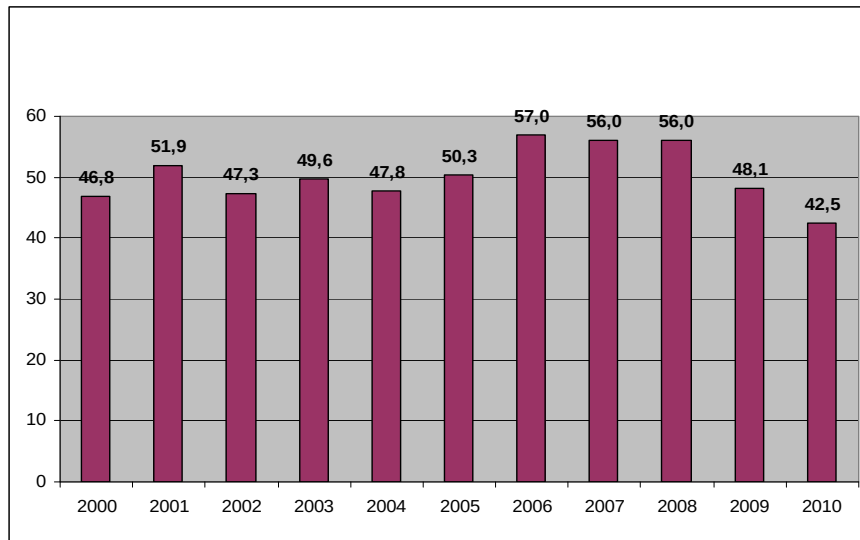
The following chart shows these negative and contradictory developments in the whole Covasna County:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 5. *Tourist accommodation capacity –Covasna County*

With respect to the indices of net using the touristic accommodation capacity in operation in Covasna County, the values reached are presented in the chart below:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 6. *Indices of net using the touristic accommodation capacity in operation (%) - Covasna County*

In Covasna this index is higher as compared to those in other counties in the region which shows that those large differences between tourism offer and demand failed to occur as in the other counties. This occurs primarily due to lower investments in tourist accommodation capacities.

The evolution of the indices mentioned above lead to the conclusion that in the mentioned period, in Covasna, the tourist potential has been exploited only to a small extent and then only during a few years. A special cause which certainly affected the orientation of tourists to this area is the poor state of road and rail transport. A cause with ethnic implication can also be invoked since most numerous arrivals belong to Hungarians.

2.4. Recovery of tourism potential in Harghita County

For better knowledge of touristic accommodation capacity and activities the analysis of the following indices is necessary:

Table 4

Tourist accommodation capacity and activity in Harghita County

Years	Touristic accommodation capacity				Arrivals (thou)	%*	Overnight stays (thou)	%*
	Existing (places)	%*	Operational (thou places-)	%*				
2000	7,256	100	1,509.6	100	87.5	100	359.1	100
2001	6,552	90.3	1,655.3	109.7	85.7	97.9	356.9	99.4
2002	6,393	88.1	1,331.6	88.2	73.0	83.4	289.9	80.7
2003	6,185	85.2	1,327.1	87.9	93.9	107.3	319.5	89.0
2004	5,964	82.2	1,472.1	97.5	100.6	115.0	343.6	95.7
2005	7,644	105.3	1,130.8	74.9	85.2	97.4	311.2	86.7
2006	7,486	103.2	1,046.7	69.3	87.2	99.7	290.3	80.8
2007	7,063	97.3	977.2	64.7	85.3	97.5	273.9	76.3
2008	7,263	100.1	918.7	60.9	77.0	88.0	242.3	67.5
2009	6,428	88.6	863.1	57.2	69.4	79.3	206.9	57.6
2010	6,909	95.2	952.0	63.1	76.9	87.9	207.6	57.8

Source: <https://statistici.insse.ro/shop/>

* These percentage data represent reductions (-) or increases (+) as compared to the base year (2000 = 100.0)

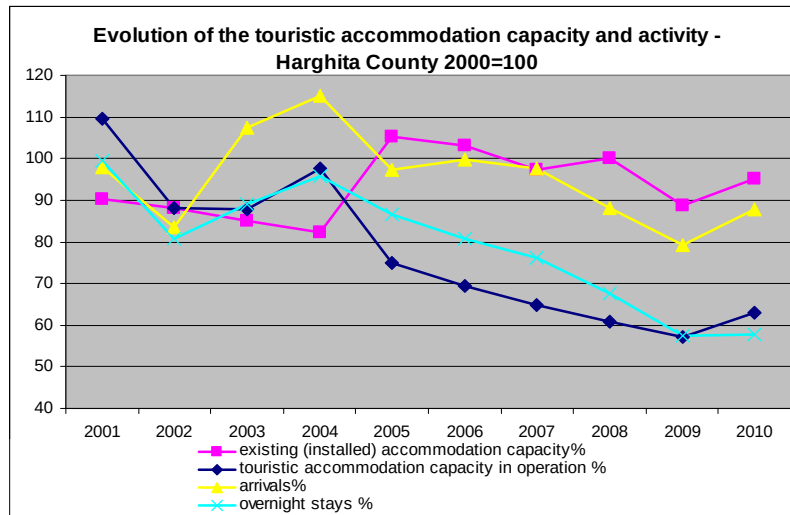
During 2000-2010, the existing touristic accommodation capacity index has known various developments for different periods, in most years it being lower than in 2000, the year of comparison. In 2010, it was approximatively 5% lower than in 2000.

With the touristic accommodation capacity in operation index, 2010 experienced even a stronger decrease, representing only 63.1% of the level reached in 2000. During the crisis, in 2009, this level was 57.2% – the lowest in the entire period.

The evolutions of these two indices show both trends of reducing the accommodation offer and of their reduced use. This is an issue that can not lead to the conclusion of a proper exploitation of the accommodation structure and, therefore, of the existing potential.

Tourist traffic indices show that Harghita County lost, between the years 2000-2010, from its former force of tourist attraction. The lowest values of the arrivals index were recorded in 2009, meaning a decrease of 79.3% as compared to the base year 2000. With overnight stays, it can be seen that reduction of this index is even more acute, representing a decrease to 57.6% as compared to 2000. These evolutions are likely to lead to the same conclusion: the significant reduction of the flow of tourists and therefore reduction of the possibility of exploitation of tourism potential existing in the county.

A visual image of touristic accommodation capacity and activity in Harghita County is presented in the following chart:



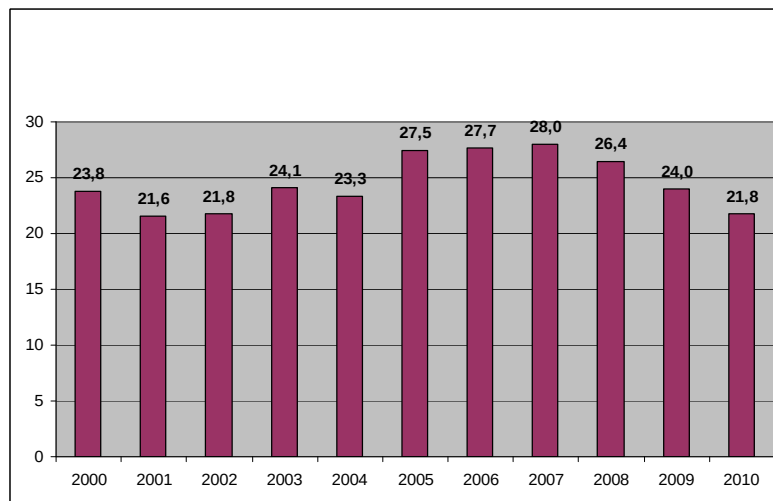
Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 7. Touristic accommodation capacity and activity – Harghita County

The mentioned involution trends are clearly visible in the chart above.

Similar negative developments are also highlighted by the net using accommodation capacity in operation.

The figure below presents these behaviours:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 8. Indices of net using the touristic accommodation capacity in operation (%) - Harghita County

The conclusion is that between 2000-2010 the indices of net using the touristic accommodation capacity in operation experienced no strong variations from one period to another, however, it was very low. This shows that, with this county too, there is a severe discrepancy between the offer and demand for tourism services predominantly due to their divergent evolution.

2.5. Recovery of tourism potential of Mures County

Evolution of the main indices specific to tourist services in Mures County is as follows:

Table 5

Touristic accommodation capacity and activity in Mures County

Years	Touristic accommodation capacity				Arrivals (thou)	%*	Overnight stays (thou)	%*
	Existing (places)	%*	Operational (thou places-)	%*				
2000	6,979	100	1,426.0	100	180.3	100	459.3	100
2001	7,482	107.2	1,355.1	95.0	130.5	72.4	403.0	87.7
2002	7,820	112.1	1,120.5	78.6	115.3	63.9	370.8	80.7
2003	7,188	103.0	1,095.0	76.8	120.4	66.8	347.3	75.6
2004	7,156	102.5	1,184.5	83.1	139.1	77.1	409.1	89.1
2005	6,201	88.9	1,570.4	110.1	203.0	112.6	516.1	112.4
2006	6,044	86.6	1,696.4	119.0	238.1	132.1	589.8	128.4
2007	6,138	87.9	1,717.7	120.5	253.5	140.6	635.3	138.3
2008	6,385	91.5	1,680.8	117.9	231.5	128.4	573.0	124.8
2009	5,854	83.9	1,669.7	117.1	200.3	111.1	538.9	117.3
2010	6,093	87.3	1,770.2	124.1	202.9	112.5	521.6	113.6

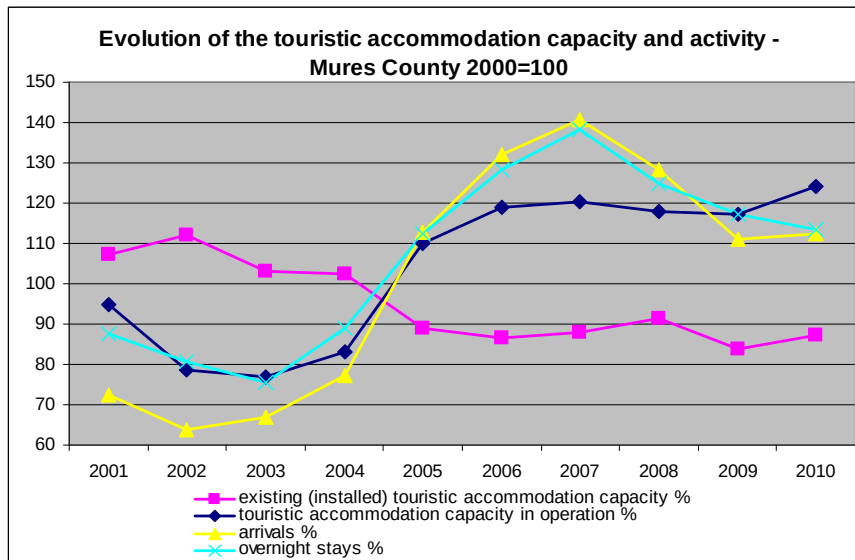
Source: <https://statistici.insse.ro/shop/>

* These percentage data represent reductions (-) or increases (+) as compared to the base year (2000 = 100.0)

Existing touristic accommodation capacity in Mures County, during time interval 2000-2010, experienced oscillating evolutions and, overall, a decline since the values as recorded in 2010 represented only 87.3% of the existing level in 2000.

On the other hand, touristic accommodation capacity in operation, excluding the years 2001-2004, has been positive in 2010, higher by 24% as compared to the reporting year 2000.

Tourist traffic indices have reached the highest levels in 2007, when Romania joined the European Union: increases by 40.6% with arrivals and 38.3% with overnight stays. In 2008-2010 significant reduction were recorded with both indices but their level was higher than in 2000: 12.5% for arrivals and overnight stays by 113.6%. On a chart, the mentioned evolutions are as follows:

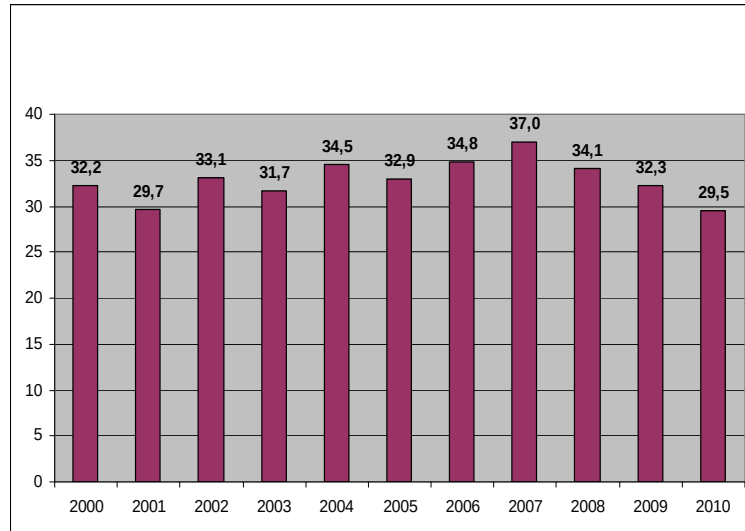


Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 9. Touristic accommodation capacity and activity – Mures County

It can be seen that in 2007 arrivals and overnight stays reached a level much higher than in 2000. An explanation for this situation is the greater number of tourists registered immediately after EU accession. After this year the trend of reduction of arrivals and overnight stays was evident, again involving the effects of the economic crisis.

In Mures County, between 2000-2010, the indices of net using the touristic accommodation capacity in operation is as follows:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 10. *Indices of net using the touristic accommodation capacity in operation (%) - Mures County*

The figure above indicates the existence of low levels of net using of the accommodation capacity in operation, with some fluctuations from one period to another. This shows that even within this county there is a discrepancy between the offer and demand for tourist services. Throughout the period 2000-2010 we can speak about stagnation in the level of net using index of accommodation capacities.

2.6. Recovery of tourism potential in Sibiu County

The evolution and dynamics of tourism specific indices, based on which we analyze the results of the recovery of the tourism potential, is as follows in Sibiu County:

Table 6

Touristic accommodation capacity and activity in SIBIU County

Years	Tourist accommodation capacity				Arrivals (thou)	%	Overnight stays (thou)	%
	Existing (places)	%*	Operational (thou places-days)	%*				
2000	5,269	100	1,000.0	100	156.8	100	275.3	100
2001	5,183	98.4	972.9	97.3	165.6	105.6	309.8	112.5
2002	4,583	87.0	831.9	83.2	164.5	104.9	293.5	106.6
2003	4,449	84.4	994.2	99.4	188.2	120.1	316.2	114.9
2004	4,589	87.1	1,107.5	110.8	214.9	137.1	368.3	133.8

Years	Tourist accommodation capacity				Arrivals (thou)	%	Overnight stays (thou)	%
	Existing (places)	%*	Operational (thou places-days)	%*				
2005	4,754	90.2	1,162.8	116.3	228.6	145.8	369.0	134.0
2006	4,333	82.2	1,384.3	138.4	252.7	161.2	434.5	157.8
2007	5,123	97.2	1,752.3	175.2	327.9	209.1	530.1	192.6
2008	5,265	99.9	1,536.1	153.6	287.1	183.1	459.3	166.8
2009	6,013	114.1	1,604.3	160.4	244.7	156.1	381.7	138.7
2010	6,538	124.1	2,018.6	201.9	228.2	145.5	401.6	145.9

Source: <https://statistici.insse.ro/shop/>

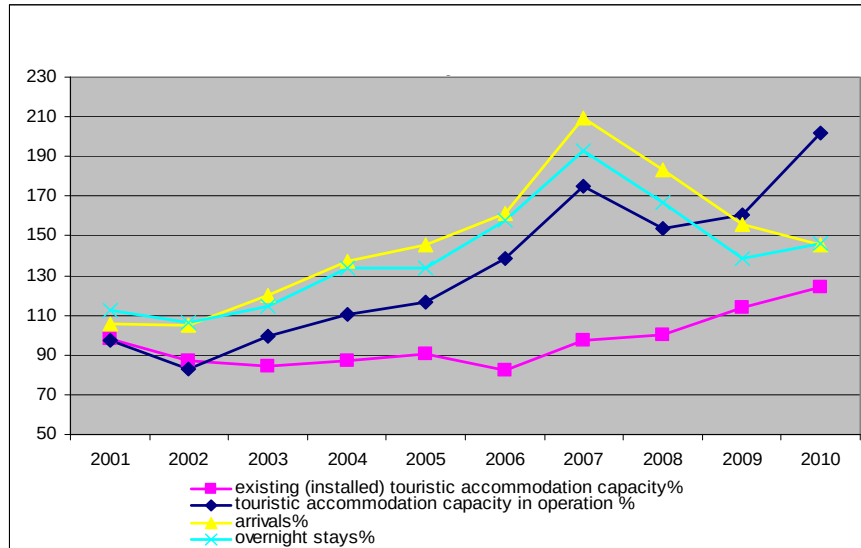
* These percentage data represent reductions (-) or increases (+) as compared to the base year (2000 = 100.0)

Both the existing touristic accommodation capacity and the touristic accommodation capacity in operation related to the period of analysis have evolved contradictorily. Between 2000-2010 it can be seen that the minimum level reached represented only 82.2% in 2006, as compared to 2000, and the peak in 2010 equal to 124.1%. With the touristic accommodation capacity in operation, the developments show, from one period to another, both reductions and increases in values but it is important to highlight that in 2010 this index recorded an increase by 201.9% as compared to 2000. The mentioned evolution is likely to show remarkable results in terms of utilization of the accommodation capacity especially since the economic crisis years have generated a trend of worsening the levels of use.

The index arrivals during 2000-2010 shows that the interest of tourists for Sibiu County as a tourist destination recorded a positive trend, between 2000-2007, the highest value being 209.1% registered in 2007. Even if the last two years tourist arrivals were below this level, it's worth noting their growth by more than 42% as compared to the level existing in 2000.

Overnights tourist traffic index experienced the same evolution as the arrival index a compared to the reference year 2000, noting that in 2001, 2002 and 2010 increases are higher than with the arrivals index.

The charts below presents the evolutions mentioned above:



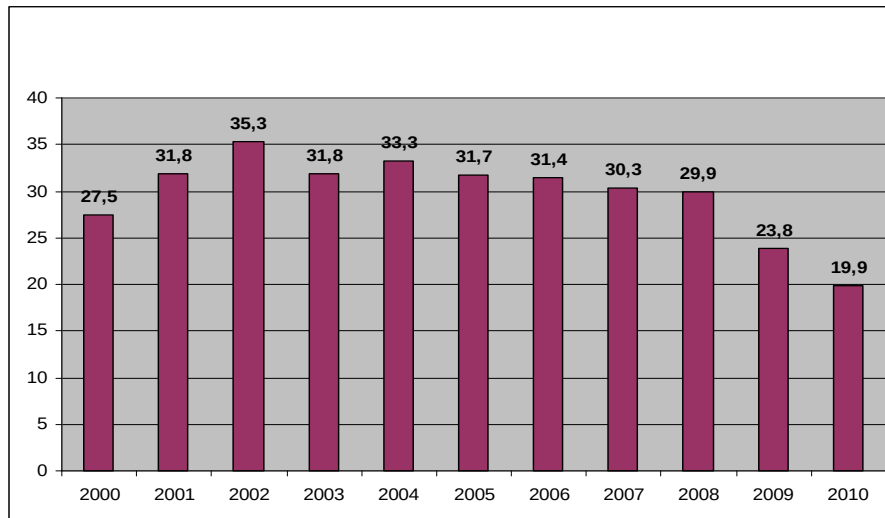
Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 11. *Touristic accommodation capacity and activity – Sibiu County*

In tourism, 2007 is a reference year for the city and county of Sibiu, given the awarding of the title of European Capital of Culture. It is also the year when performance in terms of recovery of existing tourist potential reached its highest levels.

2007 was the year that led to the rehabilitation of the historic centre, to public transport development, rehabilitation of city infrastructure and cultural infrastructure. Under the program Sibiu-European Cultural Capital 2007, 337 cultural projects were presented totalling 2,062 events for all the tastes. To have better links with the city, the modernization of Sibiu International Airport project was financed.

The strong growth, in recent years, of the touristic accommodation capacity has surpassed the tourist arrivals and their overnight stays which, actually, contributed to a mismatch between offer and demand. This is shown by the levels of net using index of operational touristic accommodation capacities, which, between 2000-2010, experienced the following developments:



Source: based on statistical data <https://statistici.insse.ro/shop/>

Figure 12. *Indices of net using the touristic accommodation capacity in operation 1 (%) - Sibiu County*

The chart above, in terms of net using the accommodation capacity in operation, indicates the existence of a specific phenomenon, namely, maintaining almost unchanged of the net using of touristic accommodation capacity in operation at around 30% until 2008 inclusively. In 2009 and 2010, a sharp drop occurs, one of the reasons being related to the economic crisis together with the stronger increase of the accommodation capacity.

The outstanding achievements obtained in the development of tourism activity in Sibiu County shows a real concern for the recovery of the existing touristic potential, which, given the low levels of using of touristic accommodations capacity in operation, indicates that there are reserves that can not be neglected in the future.

3. Conclusions

These unsatisfactory results in terms of recovery of the existing touristic potential are generated by both inappropriate behaviour from a marketing perspective of many providers of touristic services and the implementation of inadequate policies and marketing strategies both at the level of local authorities and centre one.

The use, in many cases, of high prices for the services offered, unrelated to the quality longing for quick and easy wins or neglecting the implementation

and development of modern infrastructure are actions that can not lead to better exploitation of existing touristic potential.

It can be concluded that, taking into account the analyzed indices, for a relatively long term (2000-2010), the use of the existing tourism potential in the tourist destinations of Central Development Region has seen a general upward trend, interrupted in 2009 by the effects of the economic crisis but with a slight increase in 2010 over the previous year.

Note

- ⁽¹⁾ This paper also included data presented in the author's PhD thesis entitled *Marketing contribution to Romania's tourism potential recovery from the perspective of its integration in the European Union*, "Transilvania" University of Brasov, 2011, pp. 92-137 Run-off - Monitoring index of attracted sources.

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Fiscal, Monetary Policies and Institutions' Role (Political, Social and Economic) in Pakistan

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Abstract. *The purpose of this study is to test the fundamental relationship between fiscal, monetary policies and institutions in Pakistan from 1976 to 2008. These policies are roadmap in the progress of a country. No doubt both these policies are useful tools in the hands of the government to increase the per capita GDP of the country. Such policies depict the performance level of institutions of a country. Better institutions leads to higher level of growth. Institutions perform significant role in the progress of any country. The growth targets can be achieved through institutions. Higher the quality of institutions, higher the performance would be shown by economy. Countries can reach middle-income levels despite some corruption, but further growth requires much better institutions (Easterly, 2001, pp. 234-235, 245-248, Rodrik, 2003, pp. 16-17).*

Kwiatkowski et al (1992) test is used to test unit root and short run relationship is analyzed through ECM. Auto regressive distributed lags (ARDL) shows that there is long run relationship among growth policies and institutions' role in Pakistan.

Keywords: fiscal policy, monetary policy, institutions.

JEL Codes: E52, E62.

REL Codes: 8J, 8K.

1. Introduction

Fiscal policy has vital association and effects on economic growth of a country. Fiscal policy directs the government's exertion to manipulate the track of the economy through transforming in expenditures and taxes. There are three observations concerning the responsibilities of government in the economy: Neoclassical, Keynesian and Ricardian (Bernheim, 1989). First, neoclassical paradigm considers that government participation in economic activity may crowd out private sector (Buiter, 1977). So, government should control the interference. Secondly, Keynesian sight supports the vigorous role of government due to its multiplier effects (Fazzari, 1994). Lastly, Ricardian equivalence suggestion argues for the impartiality of government deficits (Barro, 1989).

Fiscal policy has significant role in promoting economic growth especially after the great depression. Keynesian thoughts acquired strong position to elaborate the role of government in economics. Economies, especially developing economies, frequently bear inflation, unemployment and population problems. Government policies can be helpful in reducing inflation and unemployment. Fiscal policy is a robust way to assess the role of government in the growth of a country. The scope of government excess or deficit is the most significant statistic determining the impact of fiscal policy on a country (Siegel, 1979).

There are three schools of thoughts about the government expenditures and revenue. Tax and Spend School (Friedman, 1978), Spend and Tax School sponsored by Peacock and Wiseman (1979) and the third school of thought is based on the argument that government of a country may transform expenditure and taxes at the same time, it is identified as the fiscal synchronization proposition (Meltzer, Richard, 1981). Government expenditure is an easy source to change the current situation and direct the source in a good direction. Singh and Sahni (1984) found that government expenditure is a robust source which brings stability in short run fluctuations and overall expenditures of the economy. In order to meet expenditures, the governments in developing economies heavily depend upon revenues which are generated through taxation.

Revenue rising is a main target of any government to increase money. Appropriate transmission of money by the state increases economic growth. Therefore, monetary policy is used to control and regulate the money in the economy. Friedman and Hahn (1990) elaborated that the monetary authority alters the money accumulation. It can be done through open market operations or by shifting the quantity to the financial sector. Fiscal and monetary policies are important to increase the GDP and raise the level of living standard of their

people. But the developing countries like Pakistan are lacking behind and their growth is not consistent at a certain level. In addition to these policies, the serious issue of their slow growth is stemmed somewhere else. Therefore the role of institutions has significant place in the growth process. Country's institutions are basically responsible for the progress of any country. Institutions are formal and informal rules of the game governing interactions among individuals (North, 1991). Institutions are first gateway of any country through which the policies are implemented. So, for effective role of institutions, their structure and design is robust for outcome. In developing countries like Pakistan, the institutions are not functioning efficiently. Restructuring of the institutions is important because of the legacy of colonialism. Usher (1987) elaborated about the institutions of the developing countries that it is the custom to favour predation over production. Therefore it is the need of the hour to change the set up and rules of institutions in developing countries. In the process of growth, the role of different institutions like political, social and economic is significant. Economic growth and political institutions are closely associated. The high income countries have strong democracies and poor countries have horrific democracies or dictatorship. Acemoglu et al. (2001) elaborated that countries growth increases as political institutions looks after economic authorities. So the role of political institution is not only important but significant in attaining growth targets side by side economic institutions. Political rules go ahead to economic rules; however the causality runs both ways. Property rights and individual contracts are identified and implemented by political authorities, although the formation of economic interests will also manipulate the political structure. So, a given constitution of property rights will be reliable with a specific set of political rules (North, 1990). Besides political institution, social institution is basic element in the progress of a society. Man is a social animal, so this institution is as old as human being. With the passage of time this institution evolves and life becomes worth living. Goode (1904) considered that there are two basic elements of social institutions, the land and the citizens. In the early days of society these two elements are approximately the only factor to be considered. Afterward the exhaustion of social institutions might develop into a faraway more influential aspect in social evolution than any of the basic factors.

In developing countries like Pakistan, government can perform fundamental role for enhancing economic growth. In the economic survey of Pakistan (2005-06) it is declared that the fiscal policy of the Government has equally microeconomic and macroeconomic targets. Microeconomic objectives comprises a better division of earnings and wealth, evenhanded right to use to social services, fulfilling the basic needs of the poor, encouraging investment in

public sector, and improving the efficiency of both the public and private sectors to produce goods and services. Macroeconomic objectives narrate to development of the economy as a whole, national output, jobs, inflation and the balance of payments. Fiscal policy have to make certain that the stage and composition of taxes support equity and redistribution, and do not impede in people's investment and consumption choices. In the same way monetary policy plays significant role in the economy of Pakistan. In history, Pakistan has practiced cycles in inflation and economic growth. Inflation touched its climax of 23 percent in 1974, and stroked the lowest point of 2.4 percent in 2002. Likewise, the real output breach varied among -7 percent in 2002 and 6.5 percent in 2008. Historically, there has been additional focus of State Bank of Pakistan (SBP) on growth target instead of focusing on inflation and output, which shows pro-cyclical result of SBP. In addition, there has been more deviation in setting objectives of monetary policy (Malik, Ahmed, 2007). Yet there is not any significant empirical study about the institutions of Pakistan.

The organization of the study is as follows. Section II contains literature review; methodology is elaborated in section III, section IV presents empirical results and conclusion and policy implications are given in section V.

2. Review of literature

There is extensive literature on fiscal and monetary policies. In the literature effectiveness of fiscal and monetary policy has been tested comprehensively. Friedman and Meiselman (1963), Chari et al. (1991), Reynolds (2001), Shapiro and Watson (1988), Blanchard and Perroti (1996), Christiano et al. (1996), Chari and Kehoe (1991), Kim (1997), Chowdhury (1986, 1988) and Cardia (1991) have examined the impact of fiscal and monetary policies on different economic aggregates.

Some researchers favor the monetarist vision that monetary policy usually has a superior effect on economic growth and leads fiscal policy (Friedman, Meiselman, 1963, Ajaye, 1974, Elliot, 1975), whereas other support that fiscal tools are decisive for economic growth (Chowdhury, 1986, Olaloye, Ikhide, 1995). Institutions have robust role in achieving the growth targets and institutional variables are included in empirical studies as Kormendi and Meguire (1985) and Barro (1991). Property rights has significant importance and a robust variable in institutional studies, Skaperdas (1992), Grossman and Kim (1995, 1996), Hirshleifer (2001) and Dixit (2004) have elaborated that property right has strong impact in the process of growth.

Jawaid et al. (2010) elaborated the proportional effect of fiscal and monetary policy on economic growth in Pakistan applying annual data from

1981 to 2009. Cointegration test validates affirmative long run association among monetary and fiscal policy with economic growth. Though, monetary policy is found to be more efficient than fiscal policy. It is proposed that economists should pay more attention on monetary policy than fiscal.

Bruckner and Tuladhar (2010) found that how efficient was public investment in motivating the Japanese economy during the economic stagnation of the 1990s? Using a dataset of local public investment expenditure, it is found that investment multipliers are higher than for public consumption. It is also found that the usefulness of economic infrastructure investment, implemented mainly by the central government, is lower.

Nurudeen and Usman (2010) concluded that the increasing government expenditure has not transformed to development. In order to investigate the effects of government expenditure on economic growth, a disaggregated analysis is used. The results reveal that government total capital expenditure, total regular expenditures, and government expenditure on education have negative effect on economic growth. On the contrary, rising government expenditures on transport and communication, and health result to an increase in economic growth. It is suggested that Government should increase both capital expenditure and recurrent expenditure, including expenditures on education, as well as ensuring that funds meant for the development of these sectors are properly managed.

Ali et al. (2008) found the relationship among fiscal, monetary policies on economic growth in major SAARC countries for the period of 1990 to 2007. The autoregressive distributed lag (ARDL) approach is used to test the Monetarist and Keynesian argues. Money supply appeared as a noteworthy variable in both short run as well as in long run, whereas fiscal deficit is insignificant in short run as well as in long run. The results explain that monetary policy is an influential tool than fiscal policy in order to improve economic development in case of South Asian economies.

Dollar and Kraay (2003) established the role of institutions and trade on economic growth. Better institutions leads to higher level of growth. Countries having good institutions lean to extra trade. Per capita income is used as dependent variable and institutions and trade as independent variables. It is found that both the variables have significant effects on per capita GDP. However the role of trade is robust in the long run as compared to institutions.

Mohammad et al. (2009) studied the long run association between M2, inflation, government expenditure and economic growth in Pakistan by applying annual time series data from 1977 to 2007. Cointegration results explain that expenditure and inflation has important and negative impact

whereas M2 has noteworthy and positive effect on economic growth in the long run.

Ogunmuyiwa and Ekone (2010) examined the connection among money supply and economic growth in Nigeria by using the data for the period 1980-2006. OLS and Error correction mechanism is used in this study. Granger causality test is applied for checking the causality. In this study, it is found that economic growth is influenced by the level of money supply in the economy.

Taban (2010) analyzed the relationship among government spending and economic growth for the Turkey. The ARDL technique is used and MWALD Granger causality technique is applied on the quarterly data from 1987:Q1 to 2006:Q4. It is shown that the share of total government spending and the share of government investment to GDP have robust and negative impact on growth of real per capita. While the government spending to GDP ratio has insignificant effect on per capita output. The results indicate that there is bidirectional causality among government spending and economic growth, unidirectional relationship is found from per capita output growth to government investment to GDP ratio.

Acemoglu et al. (2003) elaborated that countries become heir to more extractive institutions from colonial rule are facing high volatility and economic catastrophe throughout after World War 2. Europeans are interested to just set up extractive institutions. Two stage least square (2SLS) is used to test the volatility, macroeconomic policies and the role of institutions. It is found that this high volatility and economic crisis are due to the fundamental effect of institutions on economic output.

3. Data sources and methodology

3.1. Data sources

The data employed in this study is time series, covering the period 1976-2009. The study is aimed to investigate the causal relationship between fiscal and monetary policies and institutions. The data is collected from the Hand book of Statistics of Pakistan's Economy 2005 and 2010 published by State Bank of Pakistan. The data on political rights and civil liberty is taken from Freedom House and Polity 2 is taken from Polity iv. The values for civil liberty and political rights range from 1 to 7, 1 indicates highest political rights and civil liberty and 7 shows lowest political rights and civil liberty. The data Polity 2 is taken from Polity iv and Polity 2 is combination of democracy and autocracy in Pakistan. The data on polity is range from -10 to +10, -10 shows strongly autocratic state and +10 is used to strongly democratic country.

3.2. Methodology

The study is aimed to find the relationship among fiscal, monetary policies and institutions (Political, Social and Economic). In order to analyze, cointegration and causality is checked, but first stationarity of the variables is tested. KPSS unit root test is applied which is developed by Kwiatkowski et al. (1992) and has the null hypothesis of stationarity.

A. Unit root test

A time series is regarded as a stationary if its mean and variance are self adjustable of time. In case, if the mean and variance of a time series data are changing over time, it is said to have a unit root. So, the stationarity of a time series is evaluated by carrying out the unit root test. Different types of tests are developed to check the stationarity of a time series data as Dickey-Fuller (DF) (1979), Augmented Dickey-Fuller (ADF) (1981), Phillip-Perron (PP) NG Perron (1988) and Kwiatkowski, Phillips, Schmidt, and Shin (KPSS) (1992) to check the stationarity.

Kwiatkowski, Phillips, Schmidt and Shin (1992) test is used to check the stationarity of the time series data, in this study. The KPSS test put forward a null hypothesis which presupposes stationarity and another hypothesis that presume non-stationarity. The technique used in this analysis is to decompose a time-series data into the amount of a deterministic time trend, a stationary error term and a random walk module (Verbeek, 2004).

B. Cointegration

The insight of cointegration is narrated with the long run equilibrium association among two or more variables. The economic perceptive of cointegration is that if two or more variables are related to form an equilibrium relationship across the long run, even though the series in the short run may turn aside from the equilibrium, would go closer jointly in the long run equilibrium (Harris, Sollis, 2003). There are numerous techniques accessible to perform the cointegration test. The most extensively used techniques comprise the residual based Engle-Granger (1987), and maximum likelihood based Johansen (1991), Johansen and Johansen-Juselius (1990) test. Due to the low power and other problems associated with these tests, the OLS based ARDL approach to cointegration has become popular.

The ARDL base cointegration was suggested by Pesaran and Pesaran (1997), Pesaran and Smith (1998) and Pesaran and Shin (1999). The foremost gain of this method is that it can be applied irrespective of whether the regressors are $I(0)$ or $I(1)$ (Pesaran, Pesaran, 1997). An additional benefit of this

technique is that the model takes plenty of lags to capture the data generating process in a general to specific modeling framework (Laurenceson, Chai, 2003).

Moreover, a dynamic error correction model (ECM) can be derived from ARDL through a simple linear transformation (Banerjee et al. 1993). The ECM integrates the short-run dynamics with the long-run equilibrium without losing long-run information. It is also argued that using the ARDL approach avoids problems resulting from nonstationary time series data (Laurenceson, Chai, 2003). In order to examine the impact of fiscal and monetary policies and institutions on per capita income, the following models are used.

1. Fiscal policy model

$$LPGDP_t = \alpha_0 + \alpha_1 LP_t + \alpha_2 LREV_t + \alpha_3 CL_t + \alpha_4 POL_t + \alpha_5 PR_t + \varepsilon_{1t} \quad (1)$$

1. Monetary policy model

$$LPGDP_t = \beta_0 + \beta_1 LM2_t + \beta_2 RI_t + \beta_3 CL_t + \beta_4 POL_t + \beta_5 PR_t + \varepsilon_{2t} \quad (2)$$

2. Combined fiscal and monetary model

$$LPGDP_t = \gamma_0 + \gamma_1 LM2_t + \gamma_2 REV_t + \gamma_3 CL_t + \gamma_4 POL_t + \gamma_5 PR_t + \varepsilon_{3t} \quad (3)$$

Where t is the time period, L is the logarithm; $PGDP$ is per capita GDP, P is the expenditure, REV is the revenue, CL is civil liberty, POL is Polity 2, PR is the Political rights, $M2$ is the money, RI is the rate of interest, $\alpha_0, \beta_0, \gamma_0$ are the intercepts, all α, β, γ are the coefficients and ε_t is usual error term. The variable civil liberty (CL) is used for social institution and is used by a number of economists as Scully (1988), Alesina et al. (1996) and Sciah and Warner (1995), Polity (Polity2) is used for democracy for political institution, is used by Clague et al. (1996) and Political Rights (PR) is used for economic institutions, Knack and Keefer (1995) and Owen et al. (2009) used in their studies.

The ARDL specification of above mentioned equations are as under to find empirical facts of long run equilibrium:

$$\begin{aligned} (1-L)LPGDP_t = & \alpha_{10} + \sum_{i=1}^p \alpha_{1i} (1-L)LPGDP_{t-i} + \sum_{i=0}^{q1} \alpha_{2i} (1-L)LP_{t-i} \\ & + \sum_{i=0}^{q2} \alpha_{3i} (1-L)LREV_{t-i} + \sum_{i=0}^{q3} \alpha_{4i} (1-L)CL_{t-i} + \sum_{i=0}^{q4} \alpha_{5i} (1-L)POL_{t-i} + \sum_{i=0}^{q5} \alpha_{6i} (1-L)PR_{t-i} \\ & \lambda_{10} LPGDP_{t-1} + \lambda_{11} LP_{t-1} + \lambda_{12} LREV_{t-1} + \lambda_{13} CL_{t-1} + \lambda_{14} POL_{t-1} + \lambda_{15} PR_{t-1} + \varepsilon_t \end{aligned} \quad (4)$$

$$\begin{aligned}
(1-L)LP GDP_t = & \beta_{10} + \sum_{i=1}^p \beta_{1i} (1-L)LP GDP_{t-i} + \sum_{i=0}^{q1} \beta_{2i} (1-L)LM2_{t-i} \\
& + \sum_{i=0}^{q2} \beta_{3i} (1-L)LRI_{t-i} + \sum_{i=0}^{q3} \beta_{4i} (1-L)CL_{t-i} + \sum_{i=0}^{q4} \beta_{5i} (1-L)POL_{t-i} + \sum_{i=0}^{q5} \beta_{6i} (1-L)PR_{t-i} \\
& + \eta_{10} LP GDP_{t-1} + \eta_{11} LM2_{t-1} + \eta_{12} LRI_{t-1} + \eta_{13} CL_{t-1} + \eta_{14} POL_{t-1} + \eta_{15} PR_{t-1} + \varepsilon_t \quad (5)
\end{aligned}$$

$$\begin{aligned}
(1-L)LP GDP_t = & \gamma_{10} + \sum_{i=1}^p \gamma_{1i} (1-L)LP GDP_{t-i} + \sum_{i=0}^{q1} \gamma_{2i} (1-L)LM2_{t-i} \\
& + \sum_{i=0}^{q2} \gamma_{3i} (1-L)REV_{t-i} + \sum_{i=0}^{q3} \gamma_{4i} (1-L)CL_{t-i} + \sum_{i=0}^{q4} \gamma_{5i} (1-L)POL_{t-i} + \sum_{i=0}^{q5} \gamma_{6i} (1-L)PR_{t-i} \\
& + \varpi_{10} LP GDP_{t-1} + \varpi_{11} LM2_{t-1} + \varpi_{12} REV_{t-1} + \varpi_{13} CL_{t-1} + \varpi_{14} POL_{t-1} + \varpi_{15} PR_{t-1} + \varepsilon_t \quad (6)
\end{aligned}$$

Where $\alpha_{10}, \beta_{10}, \gamma_{10}$ are intercept and coefficients, λ, η, ϖ contains long-run information and ε_t are usual error terms. The first step in the ARDL based cointegration technique is to evaluate equations using OLS. The second step is to draw the existence of cointegration by restricting all estimated coefficients of lagged level variables equal to zero. The following hypothesis is tested for cointegration in above equations through F-statistic.

H_0 = There is no cointegration in the equations 4, 5 and 6

H_1 = There is cointegration in the equations 4, 5 and 6.

Two asymptotic critical value bounds provide an analysis for cointegration as the independent variables are $I(d)$ with $0 \leq d \leq 1$. The lower bound presupposes that all the regressors are $I(0)$ and the upper bound assumes that they are $I(1)$. If the calculated F-statistics lies greater than the upper level of the bound, the null hypothesis is rejected, representing cointegration. If the computed F-statistics lies below the lower level band, the null cannot be rejected, supporting the nonexistence of cointegration. If the F-statistics fall within critical bounds, the result would be indecisive.

4. Empirical results

A. Unit root test

KPSS unit root test is operated for the stationarity of fiscal, monetary and combined fiscal and monetary models. Since the variables have mixed order of integration at level, the most appropriate methodology is ARDL cointegration for long run equilibrium. The result is given the following table.

Table 1

KPSS Table for Unit Root Test

Variables	At Level		First Difference	
	Intercept	Trend and Intercept	Intercept	Trend and Intercept
REV	0.3963***	0.1566**	0.3905***	0.1753**
RI	0.1860	0.1186	0.0628*	0.0634*
PR	0.1104	0.1128	0.1002	0.098*
POL	0.1271	0.0989*	0.1533	0.1252***
LREV	0.8568*	0.1407***	0.1680	0.0974*
LPGDP	0.3930***	0.0805*	0.0609*	0.0573*
LP	0.7822*	0.1403***	0.2364	0.1263***
LM2	0.9162*	0.1782	0.0716*	0.1660
CL	0.1861	0.0887*	0.0531*	0.0436*

Note: *, **and *** the variables are significance at 1 percent level 5 percent level and 10 percent level.

B. Fiscal policy model

Fiscal policy model with institutions is evaluated through ARDL approach. The long-run equilibrium can be checked through F. Statistics. The calculated value of equation 4 is 5.6978 to check the long run equilibrium based on ARDL bounds cointegration approach. The critical lower and upper bounds at 95% and 90% are 2.4510, 3.8779 and 2.0079, 3.2696, respectively. The calculated F-statistic surpasses the upper critical bounds both at 95% and 90% level of significance that shows a significant long run relationship between per capita GDP and REV, P, POL, PR and CL. The long run cointegrating vector is given in the following table.

Table 2

Estimated long run coefficients

ARDL(1,0,0,0,1) model selected based on Schwarz Bayesian Criterion (SBC), Dependent variable LPGDP			
Regressor	Coefficient	Standard Errors	P. Values
LP	-1.6055	0.81937	0.061
LREV	2.3344	0.79571	0.007
CL	-0.23304	0.22492	0.243
POL	-0.0078	0.032661	0.813
PR	0.35289	0.18046	0.051
χ ² -Stat. P-values			
Serial correlation	0.405183	0.5822	
Normality	2.440529	0.1782	
Heteroskedicity	4.57950	0.5139	

The fiscal variables are significant, however, government expenditures have negative sign on per capita GDP, PGDP is increasing as revenue is increasing and political right which is used to show the economic institution is significant while their role is very minor. The variable CL and POL is insignificant, which indicates that social and political institutions have no significant role in the enhancement of per capita GDP. The diagnostic tests are carried out on long run vector indicating that there is no serial correlation and heteroskedasticity in the model and the model is fit.

The results of short run equilibrium are reported in Table 3. The coefficient of ECT_{t-1} is statistically significant at 1% level and has correct sign (negative). This significance also confirms the short run cointegration between $LPGDP_t$, LP_t , $LREV_t$, POL_t , PR_t and CL_t . The coefficient of ECM_{t-1} is -0.49755, which shows speed of adjustment to the long run equilibrium after a short run shock of about 50 percent (approximately two years).

Table 3

Estimated short run coefficients

ARDL(1,0,0,0,0,1) model selected based on Schwarz Bayesian Criterion (SBC), Dependent variable LPGDP			
Regressor	Coefficient	Standard errors	P-values
LP	-.7988	0.43493	0.077
LREV	1.1595	0.46581	0.019
CL	-0.1337	0.11270	0.246
POL	-0.0039	0.01642	0.814
PR	-0.49755	0.07177	0.651
ECM(-1)	-0.49755	.11656	0.000

C. Monetary policy model

This model is evaluated with institutional variables through the technique of ARDL. The long run equilibrium is evaluated with the calculated value of F statistics. The calculated value of equation 5 is 5.2968 to find the long run equilibrium based on ARDL bounds cointegration approach. The critical lower and upper bounds at 95% and 90% are 2.4621, 3.88739 and 2.0169, 3.2796, respectively. The calculated F-statistic surpasses the upper critical bounds both at 95% and 90% level of significance that shows a significant long run relationship between per capita GDP and LM2, RI, PR, POL and CL. The long run cointegrating vector is given in the following table.

Table 4

Estimated long run coefficients			
ARDL(1,1,0,0,1,0) model selected based on Schwarz Bayesian Criterion (SBC), Dependent variable LPGDP			
Regressor	Coefficient	Standard errors	P-values
LM2	0.7757	0.0674	0.000
RI	-0.1198	0.0638	0.072
POL	0.0176	0.0304	0.569
PR	0.3080	0.1732	0.095
CL	-0.1393	0.2149	0.522
χ^2 -Stat. P-values			
Serial correlation	0.1833	0.2720	
Normality	0.4189	0.4861	
Heteroskedicity	0.2050	0.2193	

The monetary variables, LM2 and RI are significant while rate of interest has negative coefficient sign, PGDP increases as LM2 is increasing and political right which is used to show the economic institution is significant though their role is very minor. The variables CL and POL are insignificant which shows that social and political institutions have no significant role in the enhancement of per capita GDP. The diagnostic tests are carried out on long run vector and indicate that there is no serial correlation and heteroskedicity in the model and the model is fit. The results of short run equilibrium are reported in Table 5. The coefficient of ECT_{t-1} is statistically significant at 1% level and has correct sign (negative). This significance also confirms the short run cointegration between $LPGDP_t$, LP_t , $LREV_t$, POL_t , PR_t and CL_t . The coefficient of ECM_{t-1} is -0.5675, which shows speed of adjustment to the long run equilibrium after a short run shock of about 57 percent (approximately two years).

Table 5

Estimated short run coefficients			
ARDL(1,1,0,0,1,0) model selected based on Schwarz Bayesian Criterion (SBC), Dependent variable LPGDP			
Regressor	Coefficient	Standard errors	P-values
LM2	-2.6382	1.236	0.042
RI	-0.0680	0.0457	0.148
POL	0.0097	0.01698	0.561
PR	-0.0502	0.0730	0.498
CL	-0.0790	0.1202	0.516
ECM(-1)	-0.5675	0.1503	0.001

D. Combined fiscal and monetary model

The combined model of fiscal and monetary policies is examined with institutional variables with the help of technique ARDL. The long run equilibrium is evaluated with the calculated value of F statistics. The calculated value of equation 6 is 5.2968 to find the long run equilibrium based on ARDL bounds cointegration approach. The critical lower and upper bounds at 95% and 90% are 2.4510, 3.8779 and 2.0079, 3.2696, respectively. The calculated F-statistic surpasses the upper critical bounds both at 95% and 90% level of significance that shows a significant long run relationship between per capita GDP and LM2, RI, PR, POL and CL. The long run cointegrating vector is given in the following table.

Table 6

Estimated long run coefficients			
ARDL(1,1,0,1,0,0) model selected based on Schwarz Bayesian Criterion (SBC), Dependent variable LPGDP			
Regrbessor	Coefficient	Standard errors	P-values
LM2	0.7057	0.0947	0.000
POL	0.0107	0.0421	0.799
PR	0.4257	0.2464	0.096
CL	-0.3375	0.2627	0.211
REV	0.6591	0.4048	0.872
χ^2 -Stat.			
Serial correlation	0.3539	P-values	
Normality	0.8130	0.4213	
Heteroskedicity	0.4431	0.8393	
		0.4862	

In the combined monetary and fiscal model, the variables LM2 and REV are used to represent the fiscal and monetary policies, LM2 is significant and it has positive coefficient sign. However, REV is not significant, which shows that fiscal policy has no robust role in increasing of per capita GDP. PR is significant, it depicts that economic institutions have their role in enhancing the per capita GDP. The variables CL and POL are insignificant, which shows that social and political institutions have no significant role in the enhancement of per capita GDP. The diagnostic tests are carried out on long run vector and shows that there is no serial correlation and heteroskedicity in the model and the model is fit.

The short run equilibrium, results are given in Table 7. The coefficient of ECT_{t-1} is statistically significant at 1% level and has correct sign (negative). This significance also confirms the short run cointegration between $LPGDP_t$,

LP_t , $LREV_t$, POL_t , PR_t and CL_t . The coefficient of ECM_{t-1} is -0.42382, which shows speed of adjustment to the long run equilibrium after a short run shock of about 57 percent (approximately two years and three months).

Table 7

Estimated short run coefficients			
ARDL(1,1,0,1,0,0) model selected based on Schwarz Bayesian Criterion (SBC), Dependent variable LPGDP			
Regressor	Coefficient	Standard errors	P-values
LM2	-2.3824	1.3644	0.092
POL	0.0045	0.0174	0.795
PR	-0.0329	0.0753	0.661
CL	-0.1430	0.1172	0.233
REV	0.2794	0.1739	0.874
ECM(-1)	-0.42382	0.1223	0.002

5. Conclusions

In this study, the relationship between fiscal, monetary policies, Institutions (Political, Social and Economic) and per capita GDP is evaluated. Following the modern tendency, growth policies (Fiscal and Monetary) and institutions are evaluated for the period of 1976 to 2009 and provide wide-ranging analysis with better time series technique i.e. ARDL bounds testing for cointegration. The result of bound testing shows that there is a long run cointegration among the studied variables. Three models are evaluated fiscal, monetary and combined fiscal and monetary policies. In the first model, Government expenditures and revenue are used as independent variables and both of the variables are significant. The variable POL2 is used for political institution, civil liberty is used for social institution and political right is used for economic institution. Political right is significant, which reveals that economic institution has a role in enhancing per capita GDP. For monetary policy, money and rate of interest is applied to test the relationship with institutional variables. M2 and interest are significant and has role in enhancing the per capita GDP. So far as institutional variables are concerned only political rights are significant. In the third model both combined effect of fiscal and monetary policies with institutions are evaluated. Monetary policy is effective and economic institutions have role in increasing the per capita GDP. Revenue, political and social institutions have no significant role. The coefficient of ECT_{t-1} is statistically significant at one percent level of significance. It has correct coefficient sign which depicts that that there exists short run relationship.

In the light of empirical results it is carefully suggested that the government of Pakistan should take steps to improve the efficiency among fiscal aspects and pay special attention to increase the performance and efficiency of institutions, especially political and social.

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Outsourcing. The Concept

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Abstract. *In the last two decades, an economic phenomenon took place, phenomenon characterized by the transfer of manufacturing activity from the developed countries to those in developing process. This practice can be considered as the response found by the large companies to the problem of production costs that were in a continuous rising, concomitant with the rising of living standards and remuneration.*

This paper aims to analyze the concept of outsourcing in terms of its evolution, but also in terms of incentives, ups and downs associated with the concept. On the other hand, this paper seeks to capture the fundamentals of this concept veracity and whether it could be implemented in the public service.

Keywords: collaboration; competition; global governance; outsourcing.

JEL Codes: G31, G33, L25, L26.

REL Code: 17G.

1. General considerations

The concept of outsourcing came from the American terminology “outside resourcing”, meaning to get resources from the outside. The term was later used in the economic terminology to indicate the use of external sources to develop the business, which typically were using their internal resources.

According to an article published in *The Economist*, Tim Hindi stated that outsourcing is an old phenomenon that has made its presence felt since the time of the Second World War, knowing a remarkable trend especially after 1990. According to some estimates, in 1946 only 20% of the value added of US goods and services from external sources, 50 years later, the proportion has tripled, reaching 60%.

The same is repeated by Rob Aalders, in “The IT Outsourcing Guide”, which supports the fact that outsourcing is not a new phenomenon, that even now 50 years companies have outsourced advertising, legal services, maintenance and production (Aalders, 2001, p. 38).

A. Duhamel and B. Quélin say that outsourcing is often accompanied by a transfer of material and human resources to the chosen provider. It has the task of substituting domestic services in a medium or long term relationships (on average five-six years) with the customer enterprise (Quelin, Duhamel, 2003, pp. 647-661).

Although outsourcing is seen by many as a future trend, which brings many benefits to the partners, yet there are voices that question the effects of this phenomenon. Henry Kissinger is one of them, making some sarcastic comments on outsourcing during a lecture at Las Vegas, wondering if America will still remain a great power or at least a dominant one in the context of the growing importance of outsourcing. He is joined by Gary Hamel who is aware of the changes taking place in the world, and the speed of these changes. He says in the book “Leading the Revolution” that the world is aware that we have entered a new era dominated by major changes, but the question is whether we like these changes.

In recent years, the specialty literature was focused increasingly on outsourcing strategy when addressing the topic selected design variant. The plan for the development of a system is found and the option of outsourcing and as well as how this solution can be used during any project to implement the system. If in the choice of outsourcing routine activities, accounting, human resources, marketing things are relatively clear and can call on previous experiences in the systems development quite a few problems appear, due to demanding requirements of clients, lack of experience leading to difficulties in

selecting the strategy that best meet business objectives (Outsourcing Institute, 2002).

Studying the views of the authors, we could identify the following options for outsourcing, given the multiple criteria of classification (Wilcocks, Fitzgerald, 1993, pp. 201-217):

- The proportion of outsourcing: total, selective, partial.
- Outsourcing can be applied in: human resources, project development management, and service management.
- The outsourcing contract can be: general, transitional or of an economic process.
- The type of outsourcing relationships can be described as: one provider - one customer, one supplier more customers, some vendors - a client or several vendors - more customers.
- The period of outsourcing can be on long term or short term.
- Location of the supplier is local, international (offshore) and regional (near shore) - closer to the customer.

The phenomenon of outsourcing generally refers to procurement of materials and services inputs by a firm from a source outside. In this context, outsourcing can be both internal and international.

Internal outsourcing is the purchase by a company of services or material inputs from a source located in another firm within the same country.

International outsourcing is defined as the purchase by a company of services or material inputs from a source located in another country. This term includes both intra-firm international outsourcing (by which foreign supplier of inputs is still held by the firm), and distance international outsourcing (by which foreign supplier of inputs is independent of the company that uses inputs). International outsourcing is part of imports of goods and services of the country. Another term often used for international outsourcing is "off shoring".

International outsourcing is mostly used by firms in advanced economies, which directs part of the work by companies located in developing countries in particular to reduce costs.

The novelty at this time in the field of outsourcing is that it has gained momentum in the services. For a long time the service sector was considered impenetrable to international competition. With improved communications technology, such as the internet, services can cross political borders via the airwaves, getting at the same time, access to cheap labor, but well prepared.

Although outsourcing may be expected to bring long term benefits, there may be adjustment costs in the form of job losses, a process visible especially at the microeconomic level, since even in the advanced process outsourcing service is started.

2. Incentives of outsourcing

There can be seen some factors that influence changes in the world and, at the same time, make outsourcing attractive to business people around the world.

Globalization and competitiveness forces companies to find better ways to develop and use the technologies of information to obtain competitive advantages and increased performance. Development of information systems has become increasingly expensive, requiring human resources skills and competencies growing, highly trained and professional. To cope with fierce competition, companies must be efficient, to provide products to market on time and within a budget as small. Moreover, the requirements and preferences are in a continuous change. In response to these challenges, companies are trying to transfer the responsibility of having specialists, facilities and equipment to a third party, localized mostly in developing countries where there is great potential for human and multiple opportunities, which favors the development projects in a short time and at minimal cost.

Professor Michael Porter says in one of his books, "Competitive Strategy", that the effect of globalization can generate cost savings (or cost of energy production), and reducing distribution channels. "Part of this reduction may be caused by aggressive companies multinationals to spread their techniques throughout the world. Thus, Porter argues that, 'regardless of case, globalization leads to reducing impediments to global competition' (Porter, 1980, p. 86).

Although outsourcing can talk about now since a few decades, however, this phenomenon was only introduced in the field of strategic management in the 1980s, and this is due to Professor Michael E. Porter and Professor Charles Handy, both bringing into question how a company should establish strategies and how important is the company to focus on the skills they have and to outsource the rest, generating cost savings. However, more diversified product lines and services and a greater flexibility and differentiation from other producers in the market.

Prahalad and Hamel believe that sometimes, short-term outsourcing can bring some benefits, providing a shortcut to a more competitive product', but consider that this does not allow creation of the necessary abilities to maintain competitive advantage gained.

3. Pluses and minuses of the concept

When we talk about the pluses, we can immediately think of the employees of the provider who are offered permanent trainings in their field.

According to Mark Power, Kevin DeSouza and Carlo Bonifazi, outsourcing is a strategic tool used by organizations to achieve competitive advantage.

The unfavorable economic context determines the large companies to outsource business processes in the main line, thereby sacrificing a part of control over resources and information to reduce costs. The level of savings made by outsourcing companies can reach 10 to 15% on the total cost, mainly due to economies of scale.

Besides financial considerations, there are some advantages of outsourcing, such as increased focus on core processes, access to resources not available internally and standardizing processes. On the other hand, there are some concerns about outsourcing, and organizational strength, loss of control and doubts about the quality and performance.

Outsourcing initially a preferred option for small businesses and non-collateral sufficient to support activities of their specialization, in recent years has become a solution for medium and large firms.

A study made by the Economist Intelligence Unit (EIU) shows that the countries of Central and Eastern Europe, along with those of North Africa are becoming favorites for displaying the following destinations centered outsourcing, especially for companies based in Europe. According to EIU, India is becoming increasingly expensive, and European companies want countries that have a greater cultural affinity.

In Romania, the market began to grow in 2005, once the multinational IT outsourced services to local subsidiaries.

Companies hire sub-contractors when it needs additional staff and delegate them to undertake short-term activities. Outsourcing projects is made due to lack of resources and expertise of the company.

3.1. Advantages

In Romania and in Eastern Europe, the process of outsourcing is a relatively new phenomenon, which is viewed with skepticism and considered by many to be one full of risks. In highly developed countries, things are better defined, and outsourcing, in some cases, is considered a natural and necessary process in improving the situation of the company.

The Outsourcing Institute, a strong voice in the field of outsourcing, have built a top 10 reasons that a company would have to resort to such services:

1. Cost reduction and operations control;
2. Improving company focus;
3. Gaining access to the various possibilities;
4. Free internal resources for other purposes;

5. Resources are not available within the company;
6. Accelerate the benefits reengineering;
7. Driving is expensive for some time;
8. Employment equity becomes available;
9. Sharing risks;
10. Capital injection.

There are also additional benefits such as specialized, complete, professional solutions ease of installation and configuration, integrated applications, powerful, flexible and secure, increase accuracy, productivity and efficiency, reduce or even eliminate storage needs.

Also, outsourcing brings benefits at the macroeconomic level, directing capital flows to developing economies in the process. These capital flows materializing by building units of production and in creating jobs, helping to raise living standards and sustainability of these economies primarily by reducing unemployment rate and by increasing the gross domestic product.

3.2. Disadvantages

Of course there are also disadvantages, as in any association in which one of the basic conditions is a compromise.

One disadvantage is lack of knowledge of his client outsourcer environment, both internally and externally. Of course, with good collaboration, communication and patience, this impediment can be easily removed.

A second disadvantage would be an incorrect definition of the objective of outsourcing an activity, after a serious analysis of the outsourcing decision. Decision must be made taking into account both benefits and other considerations.

From these considerations we can remember poor alignment of objectives, response time and quality, with control by various methods pre supplier, and the difference in mentality between “the company employees” and “outsourcer colleagues' level of personal pride to compensation packages.

Outsourcing results are not immediate. Most organizations had a 20% decline in labor productivity in the first year of an outsourcing contract, mainly because of time spent on knowledge transfer to the outsourcing provider. After bringing their customer and supplier knowledge and goals, they can work together more effectively, thereby generating cost savings.

At the macroeconomic level, the disadvantages are more pronounced for advanced economies, because the outsourced activities are transferred to a different economy, and along with it and jobs, leading to a diminution of the living standards and an increasing at least on short-term of the unemployment rate.

Conclusions

In the analysis made in this research paper, we concluded that with the market liberalization in developing countries, large companies from developed countries have found a way to reduce costs by redirecting part of their production to subsidiaries or partners of these areas. The strategy adopted by these big companies, brought reductions of their cost production of approximately 20%, thus encouraging them to emphasize the increasing globalization with outsourcing practices.

Therefore, these practices have contributed greatly to accelerating the process of globalization, interconnecting developing economies with the already developed countries (USA, UK, Germany, Japan, etc.).

Comparing the pros and cons of the concept of outsourcing, we see that the balance tilts in favor of micro-level benefits of implementing this concept, while at the macroeconomic level we can speak of a balance between the losses suffered by the advanced economies and the benefits of developing economies. In this case we can talk about a global redistribution of income, from developed economies to developing economies.

As to the second objective of this article, the possibility of implementing the concept of outsourcing in the public service, given the macroeconomic costs caused, we believe to deepen these issues is necessary, although the world has some successful examples of outsourcing of public services (health system in the United States and part of the education system in the same country).

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The Analysis of the Ethnical Discrimination on the Manpower's Market under the Economical Crisis

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Abstract. *Discrimination means any difference, exclusion, restriction, preference or different treatment that brings forth disadvantages for a person or a group as compared to other ones that are in similar situations. The reasons on which discrimination is based can be various, such as race, nationality, ethnics, religion, gender, sexual orientation, language, age, disabilities etc. and in this case we talk about multiple discrimination. In Romania the main forms of discrimination are linked to ethnics and to sexual appurtenance. Within this column we analysed the discrimination amongst the Romany ethnics people, according to a statistical investigation (Access onto the Labour Market – A Chance for You), the research goal being to identify the answer to the following questions: Is there any discrimination inside the Romany ethnic group? What is the correlation between their level of education and their income? What is the correlation between the level of education of the parents and the respondent's?*

Keywords: discrimination; ethnic; labour market; wage; education.

JEL Codes: J71, J79, J31, J16, I21.

REL Code: 5G.

1. Preamble

Globally speaking, discrimination, irrespective of its form of manifestation, is one of the factors that have been affecting human society since the beginning of the third millennium. Globally speaking, the armed conflicts generated by religious discrimination have thus been one of the hottest problems ever since the beginning of the millennium and within certain regions ethnic discrimination is responsible for the internal conflicts in these areas. The identification of a person as belonging to a certain group may lead to his/her social discrimination, in other words he/she is excluded from the community. Most of the times such a behaviour has negative repercussions at the level of society, in countless cases bringing forth local conflicts, the specialists' recommendations being to set aside such harmful behaviours. The humane society's alert development recorded at the end of the speed century, the enhancement of Terra's number of inhabitants, the generation of new needs or the amplification of the already existing ones have led to the deepening of the existing social discrepancies, determining the reorganisation of human society. The new context has led to major changes on the manpower's market, as numerous regions have faced a high level of unemployment, so one could thus identify a new trend, namely discrimination on the manpower's market.

The modern economical theory of discrimination began with Becker (1971) and was subsequently developed by Arrow (1974). These ones think that people have certain attitudes towards those with whom they work, towards those whom they supervise and towards those from whom they buy goods, demanding in exchange compensation in order to work with the members of the discriminated group.

Arrow and Phelps (1972) studied for the first time statistical discrimination, which is based on the imperfection of information on the labour market, determined by the employer's incapacity of thoroughly knowing the labourers' productivity.

Special attention has to be paid to the discrimination template suggested by Welch (1967), who thinks that the black and the white labourers are hired together on account of their complementarities within the production. The cooperation amongst individuals belonging to different ethnic groups thus involves the existence of a fixed cost, which depends only on the number of labourers within each group and it can be determined by the preferences for discrimination or by the communication problems. The cost of cooperation between the two races is paid by the minority race and the education yield is lower in case of the minority labourers if the same are hired jointly with the

majority labourers. As a consequence thereof, the minority labourers tend to only work with the members of their group.

D.J. Aigner and G.C. Cain (1977) think that ethnic or gender discrimination is a consequence of the group discrimination, which is inevitable amongst the individuals of a group. These ones define discrimination as being the situation where the mean wages are not set up pro rata the mean productivity or the groups with the same productivity do not receive that mean compensation.

Mc Call (1972) suggested the fact that the discrimination towards the minority group brings forth an increase of the costs related to the search for a job for this one. Sloane (1985) thinks that the probability of rejecting an employee increases with the enhancement of the period of time needed for searching for a job and the opportunity cost is lower in case of the minority group than for the majority one, because their potential gains are more reduced. The conditions on the labour market can influence the labourers' activity rate and the discrimination amongst them leads both to the appearance of unemployment and to the existence of discouraged labourers.

Carneiro et al. (2003) study the ethnic discrimination on the labour market and account for the existence of the same according to the difference that exists amongst the ethnic groups from the standpoint of the skills, which are influenced by the schooling level. They showed that most of the times there is a direct link between the level of education that the parents have (the schooling years) and the one that their children receive or will receive.

The major changes happened in Romania in the past 20 years have brought along the rearrangement of the manpower's market, the people capable of working being subjected to a process of adaptation to the new conditions imposed. A special problem within the Romanian society is raised by the Romany ethnics, the official statistics considering that the number of those who belong to this ethnics is approximately 1.3 – 1.5 million inhabitants, however according to the non-official statistics of the various non-governmental organisations, their number would be approximately four million stable inhabitants, who are added around one million of mobile inhabitants that leave the country for short periods of time. The integration of these ethnics members into society proves to be a very difficult problem both at the national level and at the international one.

The National Council for Fighting Discrimination (NCFD) initiated an investigation in order to catch up the Romanians' attitudes and opinions regarding the most important issues linked to the phenomenon of discrimination in the last quarter of 2010. The research was performed according to an individual sociological questionnaire applied to a sample of 1,400 adult people

belonging to all the regions of the country, both from the urban environment and from the rural one, the size of those respective localities (for the urban environment) and the administrative type (in case of the rural environment) being taken into account.

Subject to the context of discrimination, the labour market is top one in terms of the discrimination situations frequency. The most discriminated group is thus represented by the people infected with the HIV virus, 71 % of the interviewed people considering that this group is the most often discriminated upon hiring, and 67 % choose the context linked to the workplace. The second place is held by the gays, where 50 to 55 % of the interviewed people think of the workplace and of the public premises as being the most often encountered discrimination contexts. The third place is held by the Roma, 56 % of the interviewed people thinking that discrimination at one's workplace and upon hiring is the most often encountered context of discrimination. Lastly, the context of women's discrimination at their workplace is outlined by 13 % of the interviewed people, some other 11 % thinking public premises as being a major context of women's discrimination.

The problem of social exclusion on the labour market as compared to the disadvantageous minorities has led the interviewed people's opinion (71 %) to the common point, where the people infected with HIV, even though they have the same training, find a job more difficultly as compared to the people who do not suffer from this illness. In the same context, the Romany ethnics people represent, in 70 % of the interviewed people's opinion, the most disadvantaged ethnic category when it comes to being assigned a job.

The research point related to the self-analysis of the majority people (the Romanians) and to the analysis of the minority ones from the viewpoint of the majority ones has brought forth a few characteristics of the groups that are worth mentioning, in order to understand the reasons that lead to a higher or lower percentage of discrimination, depending on the minority ethnical group to which they relate. The results obtained from the questionnaires have led to the following stereotypes:

Table 1

Stereotypes and preconceived ideas subject to the ethnic categories

Ethnics	Positive assessment	Negative assessment
Romanians (self-assessment)	Hard-working, tolerant	Disunited, coward, irresponsible
Roma	United, brave, audacious	Lazy, aggressive, dishonest
Hungarians	United, hard-working	Intolerant, aggressive, avaricious
Germans	Hard-working, honest, responsible	Avaricious
Jews	United, hard-working, peaceful	Avaricious

Source: The authors processed data from the NCFD's Synthetic Report - TOTEM 2010.

Ethnic belongingness was assessed as being important for the success in life by 24 % of the subjects that answered the questionnaire. Consequently, one thinks that the belongingness to a certain ethnic group matters for: finding a job; acquiring a place to stay; the access to medical services; the access to legal services; the access to public/administrative services; the access to education.

This study supports the idea related to the fact that people should shape their discriminatory opinions depending on the actions and the happenings to which they have personally assisted and not on what other people have said, which can be evasive, opinion-sided, subject to omissions and interpretations.

2. The research methodology

The complexity and the diversity of the social-economical phenomena call for adequately tackling with the problems appeared during their study. Seeing that a study of the total communities is costly from the point of view of time and of the financial resources involved, one had to study certain parts of the general information-related groups that reproduce, at a reduced scale, the statistical populations taken into consideration and the thus obtained results can be extrapolated at the global level, according to the results obtained in conformity with the theory of probabilities. Taking into account the fact that the social-economical phenomena are influenced by countless factors, the identification of the laws for their optimal management, in other words of the rules according to which these phenomena manifest themselves in the real environment, represents a process of approximation carried out in the context of incomplete *a priori* information. The determination of the evolution trajectories associated to these complex phenomena that can be seen within human society supposes to notice their dynamics in the real environment, the appropriate template for the analysis within the subsequent scientific approach being to be determined according to the measurements performed at the level of the statistical facilities comprised in the study. In this way, the approximation is made by virtue of an ample process of measurement carried out at the level of the facilities selected from the general community, which are grouped within the statistical sample, the rules for their selection being made according to the statistical selection theory and in this way the bi-univocal correspondence between the real environment and the transformed space where each statistical unit is uniquely identified by the vector of the characteristics associated thereto takes shape. The representation of the general communities by means of the statistical samples constitutes an elegant and robust method of identifying the trends that exist at the level of the analysed populations, of the meaning of the identified links, the formulation of certain legal characteristics regarding the evolution of the phenomena that are the subject-matter of the present

study thus outlining their large scale manifestation. From this point of view, the social-economical phenomena are deemed to have a mass character, as they are the result of the action of a great number of factors, their achievements having certain irregularities and thus justifying the use of the stochastic processes in their study.

The statistical sample thus appears to be an information-related entity, the study of the units of which it is composed enabling the obtaining of a vision relative to the characteristics of the statistical population to which they pertain. The identification of the significant links that statistically exist within the population analysed, the establishment of the existing causal relations and of their meaning within the statistical investigation by polls are relevant at the global level if the sample subjected to the scientific approach meets the representativity conditions, thus contributing to the deepening of the scientific knowledge in the field under study.

The necessary and sufficient condition for the results provided by the poll investigation to be used for making statistical inferences is that the population's structure should be reproduced within the sample, which means that each statistical unit should have the possibility of being selected in the sample. There are, however, situations where the poll investigation is exploratory in character, the results obtained being orientative and useful for the identification of the existing local aspects, the community analysed in this situation for the sample elaboration not observing the conditions imposed by the theory of probabilities.

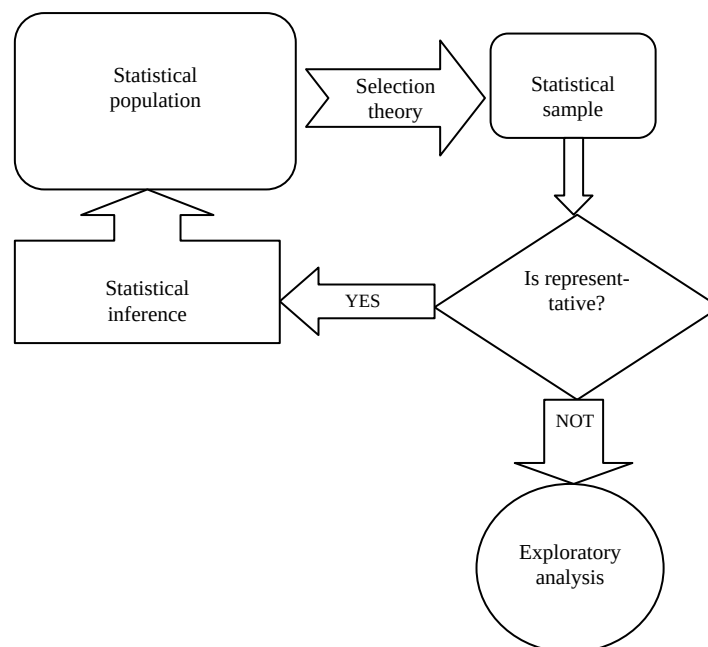


Figure 1. *The logical scheme associated to the poll statistical investigation*

Given that the indicators values are obtained after a process of measurement, there appears the possibility that the remarks made could be affected by measurement errors, which thus lead to the relation below:

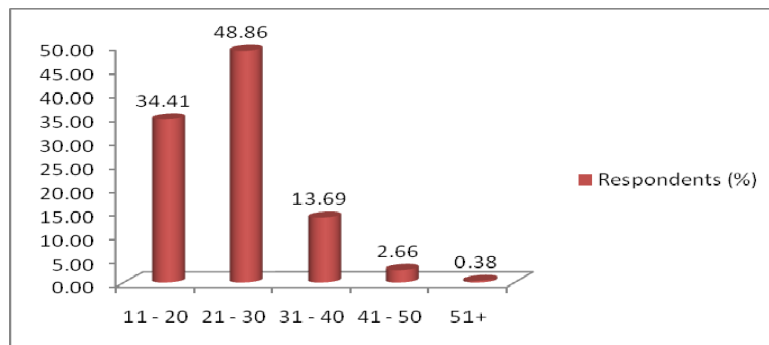
$$\text{Measured Value} = \text{Real value} \pm \text{Random error} +/\text{-- Systemic error}$$

The large volume of information that exists on the poll-based statistical investigation shows the fact that this field of scientific research arouses the interest of numerous researchers, the supporting point within the development of the scientific investigation being offered by the practical results obtained.

For the database we used the *Access onto the Labour Market – A Chance for You*⁽¹⁾ poll, which was carried out between February and April 2010 at the regional level.

3. The research results

The sample volume was composed of 529 people. The selection of the statistical units was made within the Romany ethnic population, the selection range being comprised between the ages of 16 and 57. The information-related synthetisation concerning structure was performed by grouping the respondents on five equal age ranges: 11-20, 21-30 etc. The graph below shows that most respondents fell into the 21-30-year age category (48.86%) – Figure 2. The analysis of the database shows that approximately 97 % of the respondents are young people, fit for the manpower's market.

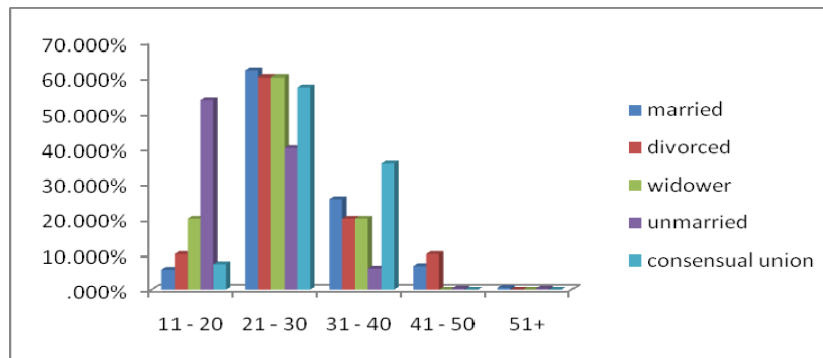


Source: The authors processed data.

Figure 2. Structure by age of respondents

At the level of the sample obtained, every second interviewed person is single and as regards the married people, one person of three is within the

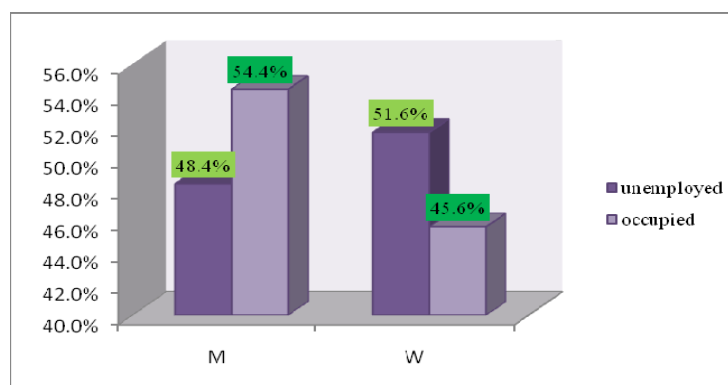
21-30-year age category, as Appendix 1 shows (The Respondents' Structure Depending on Their Civil Status). The graph below shows two poles: the former one is made up of the married people and the latter one is composed of the single people, in the statistical units included in the study the weight of the single people being high, which proves the exit from the classic patterns associated to this ethnics (Figure 3).



Source: The authors processed data.

Figure 3. *Marital status of respondents*

Out of the totality of respondents, 75.8% have a job – see Appendix 1 (The Structure of the Respondents' Occupation) and out of them 54.4% are men and 45.6% are women. The graph below shows that the weights are approximately equal between the men and the women from the standpoint of the occupation (Figure 4).



Source: The authors processed data.

Figure 4. *Occupation by gender*

In order to analyse the causal relationship between the father's and the respondent's occupation, we correlated the answers from the 'What is your father's occupation?' question to the 'What is your occupation?' one, because the Romany families are patriarchally organised. For 78.26% of the respondents the father has a job, as Appendix 1 shows (*The Father's Occupation*). At the level of the thus constituted sample, in case of 66.9% of the interviewed people, both the father and the respondent have a job (Table 2). The correlation of the answers to the two questions is statistically relevant (Appendix 2: *The Correlation Coefficient between the Respondent's Occupation and the Father's*), as there is a direct link between the father's occupation and the child's. Within these ethnics, conservatism plays a very important part, as the trade passes over from one generation to another.

Table 2

Correlation between the father's and the respondent's occupation

			Respondent's occupation			Total
			Died	Unemployed	Occupied	
Father's occupation	Unemployed	Count	13	55	60	128
		within Occupation_1	10.2	43.0	46.9	100.0
		within Occupation_02	39.4	67.1	14.5	24.2
		of Total	2.5	10.4	11.3	24.2
	Occupied	Count	20	27	354	401
		within Occupation_1	5.0	6.7	88.3	100.0
		within Occupation_02	60.6	32.9	85.5	75.8
		of Total	3.8	5.1	66.9	75.8
Total		Count	33	82	414	529
		within Occupation_1	6.2	15.5	78.3	100.0
		within Occupation_02	100.0	100.0	100.0	100.0
		of Total	6.2	15.5	78.3	100.0

Source: The authors processed data.

Most respondents' incomes are less than RON 1,000, irrespective of the age category, which is accounted for by the nature of the occupations deployed by the Romany people (Appendix 2: *The Income Structure According to Age*), which are activities that suppose a low level of education. In accordance with the economical theory, aging till a certain level leads to the incomes enhancement, but within this sample analysed this theory is not valid.

On analysing the correlation between the respondents' income and level of education, the statistical tests show the presence of asymmetry, as the Cramer statistics, the contingency coefficient and ϕ reject the void hypothesis corresponding to the significance threshold of 5 %. Between these variables there is no significant statistical link, which is a fact highlighted by the Pearson correlation coefficient, and the determined categories are not correlated pro rata

the Spearman levels correspondence (Table 3). These conclusions are confirmed by the way in which the interviewed people's answers are distributed within the sample analysed. According to the numerical results provided by the sample, most Roma representatives carry out activities that do not call for a high level of training; in addition, in most cases they have a low level of education. Taking into account the structure of the sample obtained, the people with a low level of education (grammar school-type at the most) represent 61.36% of the sample volume and approximately 82% of the respondents earn less than RON 1000. (Appendix 2: The Respondents' Structure According to the Last School Graduated From).

Table 3

Symmetric measures between income and education				
Symmetry coefficients				
	Value	Asymp. Std. Error	Approx. T	Approx sig.
Phi	1.458			0.000
Cramer's V	0.515			0.000
Contingency Coefficient	0.825			0.000
Pearson's R	0.118	0.040	2.290	0.023
Spearman Correlation	0.249	0.0051	4.965	0.000
N of valid cases	375			

Source: The authors processed data.

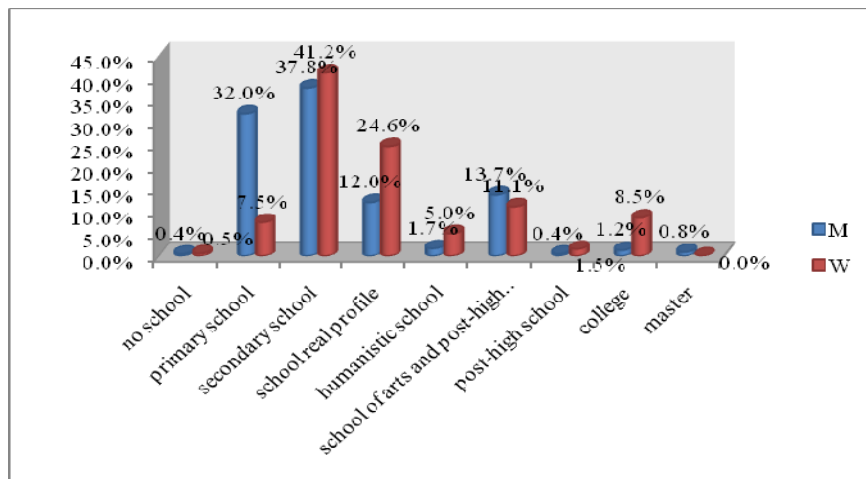
As a result of the sample answers one noticed a reticence of the interviewed people in declaring their incomes obtained in the latest month of activity. This attitude can be accounted for by the fact that the stereotypes related to the Romany ethnic group determines their members to refuse answering this question, so that out of the 529 people analysed, 152, that is 28.7%, did not answer (Appendix 2: The Validation of the Answers Related to the Latest Month's Earnings).

Table 4

Income structure by gender (%)								
			Income					Total
			<= 0	1 - 1000	1001 - 2000	2001 - 3000	3001+	
Sex	M	Count	2.00	179.00	28.00	0.00	4.00	213.00
		within sex	1	84	13	0	2	100
		within income 01	50	61	55	0	57	59
		of total	1	50	8	0	1	59
	W	Count	2.00	116.00	23.00	2.00	3.00	146.00
		within sex	1	79	16	1	2	100
		within income 01	50	39	45	100	43	41
		of total	1	32	6	1	1	41
Total		Count	4.00	295.00	51.00	2.00	7.00	359.00
		within sex	1	82	14	1	2	100
		within income 01	100	100	100	100	100	100
		of total	1	82	14	1	2	100

Source: The authors processed data.

On analysing the incomes structure according to gender, one noticed that, as an average, the number of men that earn up to RON 2,000 is greater than the women's (Table 4). Even though the two categories of respondents according to gender are approximately equally distributed at the level of the entire sample (Appendix 1: The Sample Structure According to Gender), the number of men that actually answered the question related to the income obtained during the latest month represents 59% of the number of valid answers, as compared to the 41% one corresponding to women. The identified structure can also be justified by the fact that amongst the male gender people the degree of occupation is higher than amongst the female gender ones. Contrary to the perception on the income differences between men and women, especially in case of this social category, the recordings analysis shows that there are no big discrepancies between the level of the income obtained by women and men.



Source: The authors processed data.

Figure 5. Respondents' Structure according to the Last School Graduated From

The sample analysis showed that the men have a low level of education and that their weight was higher than the women's in terms of elementary school and of the arts and crafts category, as they are more oriented to practical activities. Unlike them, the women are dominant in terms of secondary education, post-secondary school and college. This trend can be accounted for by the measures adopted at the European level for the diminishment of discrimination amongst women, notably for the ethnic group under study (Figure 5).

Table 5

Correlation between father's education and respondent's education

	Value	Asymp.Std.Error	Approx.T	Approx.Sig
Pearson's R	0.41	0.04	9.42	0.000

Source: The authors processed data.

According to the sample analysed one has identified a direct causal relation between the father's educational level and the child's level of training, which is a statistically significant relation, as the table above shows it.

4. Conclusions

Nowadays the problem of integrating Roma into society is a major goal at the level of the European Union, seeing the generalisation of the preconceived ideas linked to this ethnics. Romania constitutes a solid research base, because of the great number of Romany people that live in this European area (the non-official statistics state that the number of Roma is approximately 4 million inhabitants).

The following conclusions have come out from the poll investigation performed at the level of the sample:

- within the ethnic group there is no major discrepancy between the incomes obtained by women and those obtained by men;
- the male gender people are mainly oriented toward practical activities (arts and crafts), as compared to the female gender people, who tend to pursue their education;
- because of traditionalism, the respondents tend to continue their fathers' trade, even their level of training;
- no matter what the age might be, the earnings made by the respondents are less than RON 1000, because they deploy activities that do not suppose a high level of education;
- the sample under analysis is asymmetrical from the viewpoint of the link between the incomes and the level of education, because the most interviewed people can mainly be found in one category of income and level of education (that is to say the RON 1000 income and the grammar school studies category).

The analysis of the results obtained by virtue of the statistical inferences showed that the Romany ethnics people have a different behaviour as compared to the perception that exists about this ethnic group within the Romanian society, thanks to the efforts made by certain non-governmental authorities and organisations for the mitigation of the Romany ethnics people's discrimination.

Acknowledgements

This work was supported by CNCSIS+UEFISCSU, project number PNII-RU code PD: 281/2010 (number 77/2010).

Note

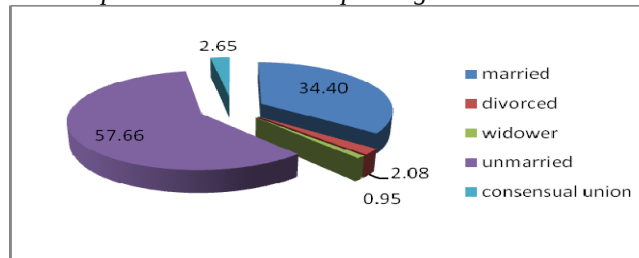
- ⁽¹⁾ Research project no. 56420, co-financed from the European Social Fund by means of the 'Human Resources' Development' Sectorial Operational Programme 2007-2013. Priority axis 5: 'The Furtherance of the Active Occupation Measures'. The major intervention field 5.1.: „The Active Occupation Measures Development and Implementation”.

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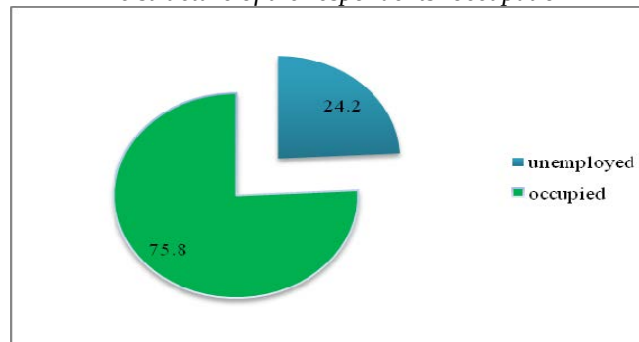
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Appendix 1

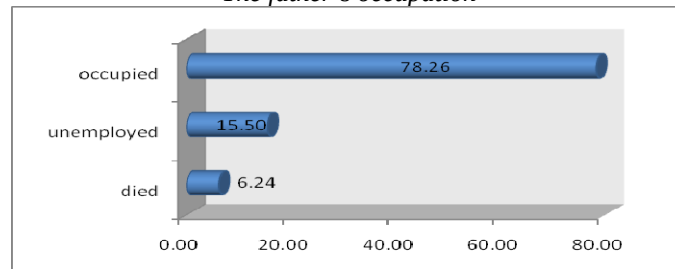
The respondents' structure depending on their civil status



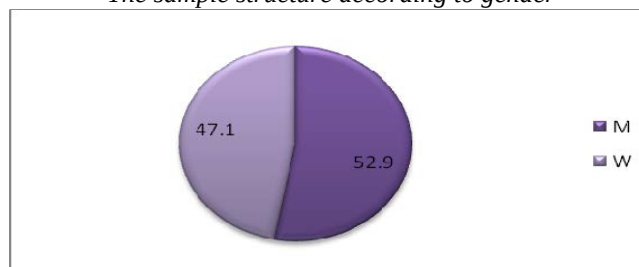
The structure of the respondents' occupation



The father's occupation



The sample structure according to gender



Appendix 2

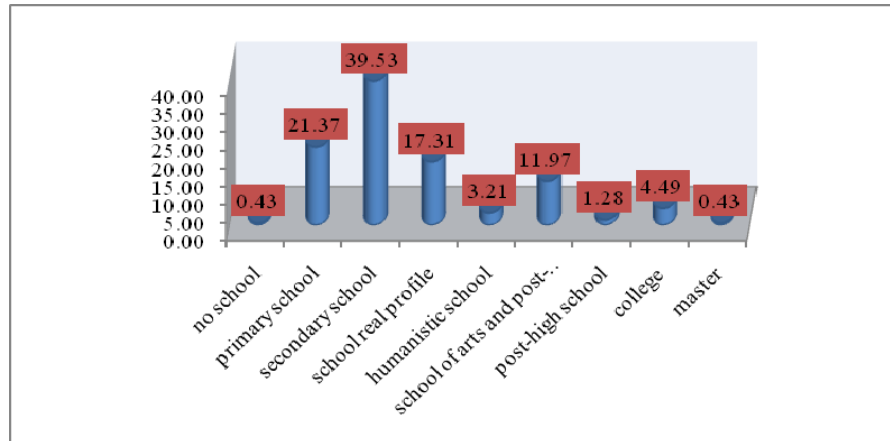
The Correlation Coefficient between The respondent's occupation and the father's

	Value	Asymp.Std.Error	Approx.T	Approx.Sig
Spearman Correlation	0.412	0.046	10.387	0.000

The income structure according to age

			Income_01					Total
			<= 0	1 - 1000	1001 - 2000	2001 - 3000	3001+	
Age	11 - 20	Count	1	89	34	1	1	126
		% within Age	0.8%	70.6%	27.0%	.8%	.8%	100.0%
		% within Income_01	25.0%	28.7%	64.2%	50.0%	12.5%	33.4%
		% of Total	0.3%	23.6%	9.0%	0.3%	0.3%	33.4%
	21 - 30	Count	3	167	16	1	5	192
		% within Age	1.6%	87.0%	8.3%	0.5%	2.6%	100.0%
		% within income_01	75.0%	53.9%	30.2%	50.0%	62.5%	50.9%
		% of Total	0.8%	44.3%	4.2%	0.3%	1.3%	50.9%
	31 - 40	Count	0	47	3	0	2	52
		% within V	0.0%	90.4%	5.8%	0.0%	3.8%	100.0%
		% within income_01	0.0%	15.2%	5.7%	0.0%	25.0%	13.8%
		% of Total	0.0%	12.5%	.8%	0.0%	0.5%	13.8%
	41 - 50	Count	0	6	0	0	0	6
		% within Age	0.0%	100.0%	0.0%	0.0%	0.0%	100.0%
		% within income_01	0.0%	1.9%	0.0%	0.0%	0.0%	1.6%
		% of Total	0.0%	1.6%	0.0%	0.0%	0.0%	1.6%
	51+	Count	0	1	0	0	0	1
		% within Age	0.0%	100.0%	0.0%	0.0%	0.0%	100.0%
		% within Income_01	0.0%	0.3%	0.0%	0.0%	0.0%	0.3%
		% of Total	0.0%	0.3%	0.0%	0.0%	0.0%	0.3%
Total		Count	4	310	53	2	8	377
		% within Age	1.1%	82.2%	14.1%	0.5%	2.1%	100.0%
		% within Income_01	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
		% of Total	1.1%	82.2%	14.1%	0.5%	2.1%	100.0%

The respondents' structure according to the last school graduated from



The validation of the answers related to the latest month's earnings

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
Sex * Income 01	359	67.9%	170	32.1%	529	100.0%

Correlation between father's education and respondent's education

	Value	Asymp.Std.Error	Approx.T	Approx.Sig
Spearman Correlation	0.048	0.54	0.908	0.364

The Local Development Initiatives in the Rural Development Context

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Abstract. *The European Union Leader initiative is an important chance for the development and tightening of the rural-urban continuum in Romania. Fundamental elements of this initiative are the local action groups. These local action groups are conceived rather as an ad hoc framework for exchanging ideas, for debate on matters of local interest, on initiatives to boost economic activities. Thus, these local partnership structures can be self-organized by very real problems and directions: to promote a brand of product made in a certain area, the image of a tourist attraction, of traditional occupations, crafts of products etc.*

This paper aims to highlight the difficulties of economic progress for the Romanian rural area, considering that the Leader initiative would be a good opportunity to accelerate this process. To emphasize this, a review of the dimension of the Romanian rural problem was done. Also, I examined how specific indicators and official recommendations have stimulated the initiatives for organizing local action groups. Finally, arguments in favour of local action groups as the solution to the rural problem of Romania are provided.

Keywords: local action groups; regional disparities; economic cohesion; rural development; economic integration.

JEL Codes: O18, R11.

REL Code: 20J.

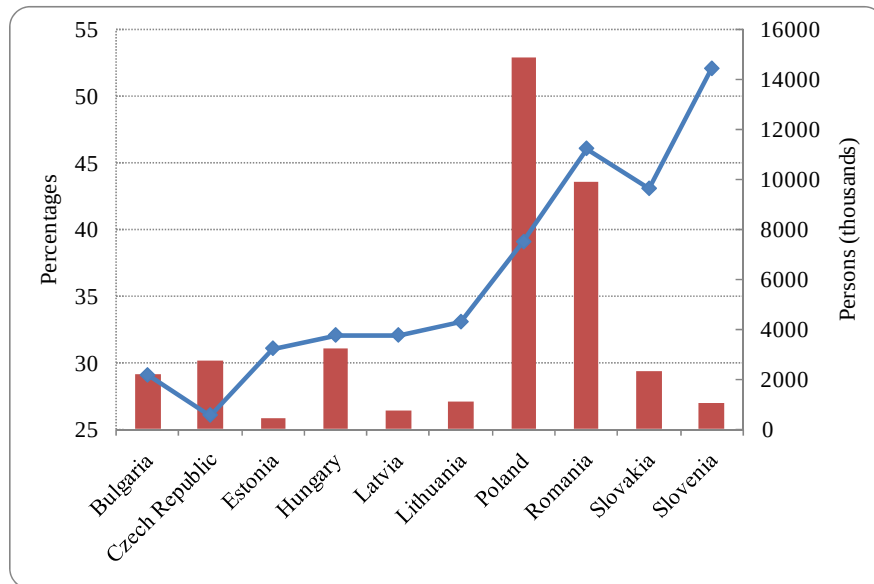
Introduction

The integration of the former communist countries of Central and Eastern Europe in the EU is difficult, challenging and fragmented. The differences in economic and social performance since accession seem to have widened after the economic and financial crisis, which generates a fragmentation process of the peripheral area of the EU. These fractures are becoming more evident both on a national dimension and on a regional one, but especially on the urban-rural habitation dimension. The urban – rural disparities are by far the most conspicuous in the heterogeneous scenery of the Central and Eastern EU both from the synchronic and diachronic perspective. Without insisting on the causality of the spatial distribution of the economic activities (these can be found in Ailenei et al., 2011a), namely on the structural changes from the history of the national economies development, even under the conditions of an optimistic attitude on the present (which could consider the disparities as being ephemeral), the concern is about the significant differences in understanding the time horizon of the economic development compared with the individuals belonging to the two areas of habitat. Often, the Eurobarometer shows net discrepancies in the assessment of the economic development opportunities, degree of optimism, confidence in progress, etc. between the inhabitants in urban areas compared with those from rural areas. Under these circumstances the European integration of the former communist countries of Central and Eastern Europe has an additional concern – the rural area.

Financially and institutionally supported through pre-accession funds these countries have made great efforts to modernize the rural area (Ailenei et al., 2011b). After the EU accession, the new member states from Central and Eastern Europe have benefited from additional financial resources made available by the European Agricultural Guidance and Guarantee Fund. However, the opportunities to improve the quality of the European integration of the rural area in the new EU Member States have increased dramatically with the entry into force of the European Agricultural Fund for Rural Development (EAFRD). In accordance with the principle of the strategic approach of the EAFRD use, the Member States have to develop and implement the National Rural Development Programmes.

1. The dimensions of the Romanian rural problem

In Romania rural areas cover about 87.1% of territory and 45% of population (the second largest after Slovenia). However, in absolute terms, Romania has the second rural population among the new Member States after Poland (which has a smaller share of the rural area, Figure 1).

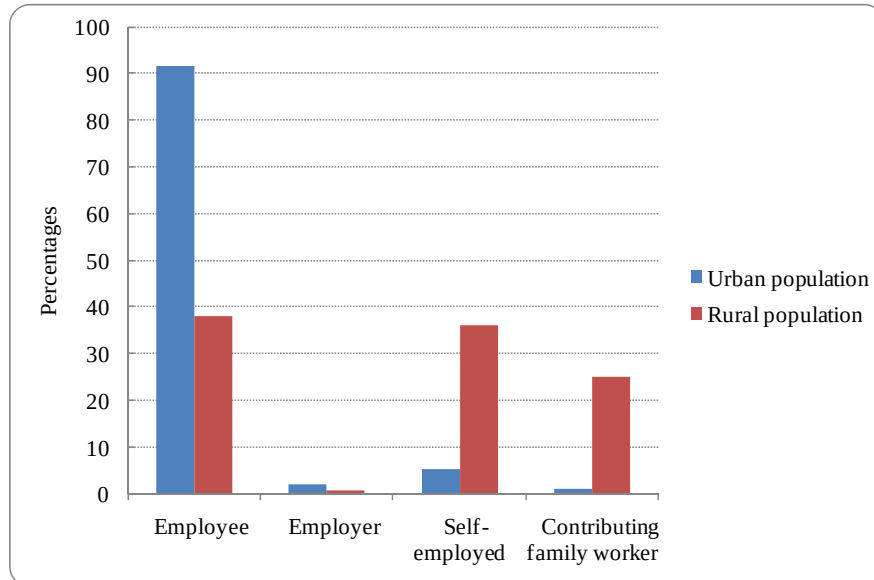


Source: NISS data.

Figure 1. Rural population in East European Countries in 2009

The high percentage of the rural population becomes a problem when it is associated with significant differences on employment of the labour force, the employed population structure, workers' skill level, household income, infrastructure facilities, quality of life, access to education etc.

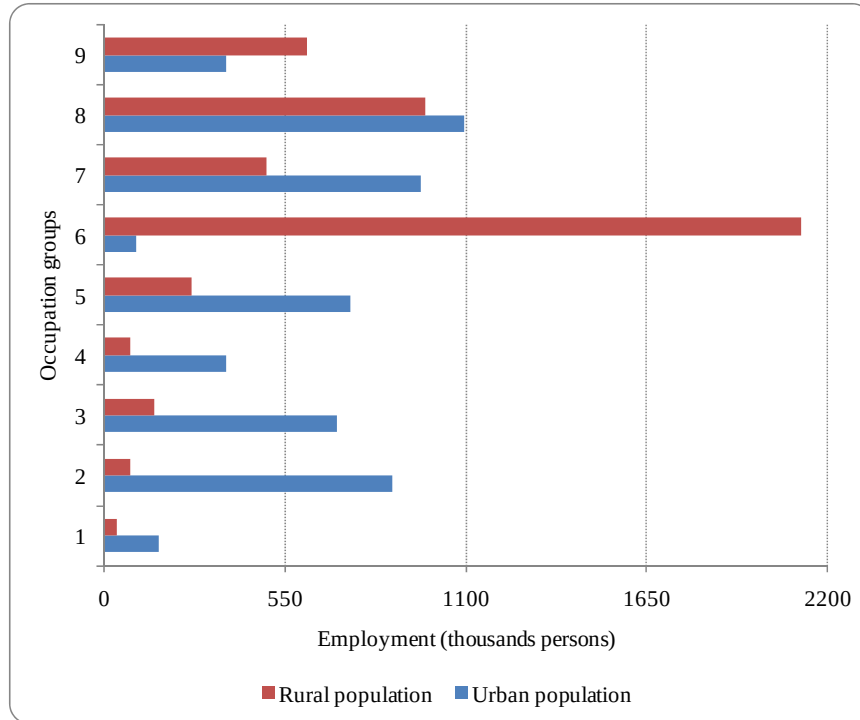
Romania has a gap of eight percentage points in employment for the urban area as compared to the rural area. This disparity is greater when considering the structure of the employed person's status (Figure 2). One can see the apparent predominance of the employees and employers in urban areas, namely self-employed and workers from family farms in rural areas. The problem here is related to the effects on labour productivity, entrepreneurship, respectively the effects of attracting the people in the labour force market (since freelancers are often occasional workers and most farms are in fact small households).



Source: Household Labour Force Survey (HLFS) – 2009.

Figure 2. *Employment structure by status in employment in 2009*

The rural-urban disparities are even more obvious regarding the occupational structures of the employed population (Figure 3). It is noted that the highly qualified professions predominate in the urban area, while in the rural area farmers and unskilled workers predominate.



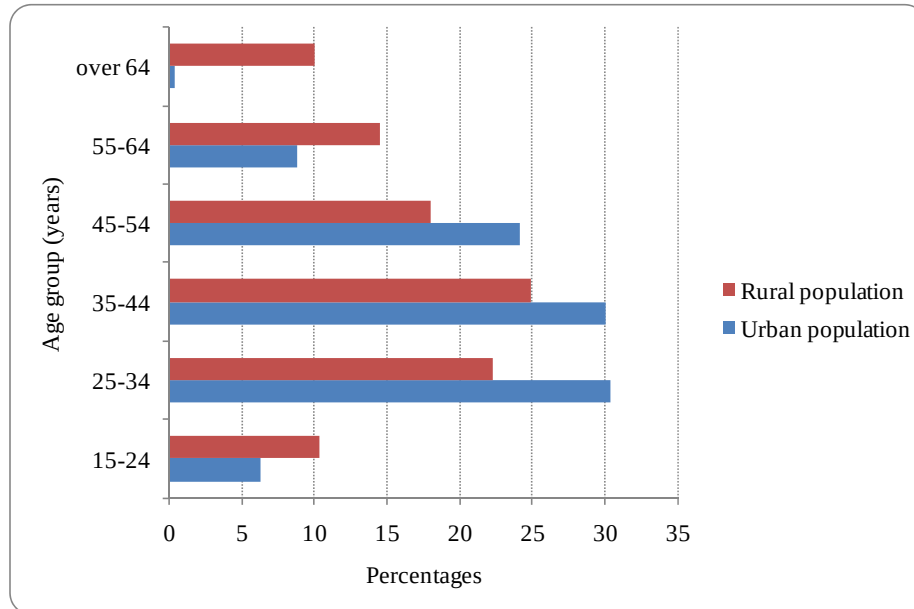
Source: Household Labour Force Survey (HLFS) – 2009.

Figure 3. *Employment structure by occupation group in 2009*

The occupation groups from the figure above are as follows:

1. Members of legislative body, executive, leaders of public administration, leaders and clerks of socio-economic and political units;
2. Specialists with intellectual and scientific occupations;
3. Technicians, foremen and assimilated;
4. Civil servants;
5. Operative workers in services, trade and assimilated;
6. Farmers and skilled workers in agriculture, forestry and fishery;
7. Artisans and handicraftsmen in machinery and installations maintenance and adjustment;
8. Other categories of occupations, of which:
9. Unskilled workers.

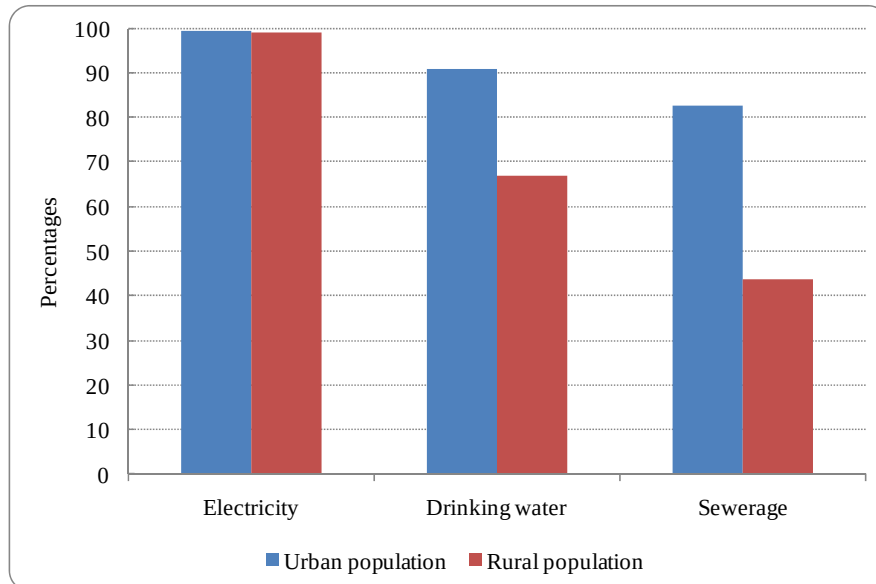
Even the employed population's age structure is unfavourable to the rural area (Figure 4) where the elderly workforce (over 55) and the new cohorts of labour force (15-24 years) predominate. In contrast, the most productive age groups of the employed population (between 24 and 54) are distributed mainly in the urban areas.



Source: Household Labour Force Survey (HLFS) – 2009.

Figure 4. *Employment structure by age group in 2009*

The dominance of the agricultural activities, of the less skilled and experienced elder labour force in the rural areas has direct effects on incomes and living standards of the people in this area. The disparities regarding the standard of living between the two habitat areas can also be highlighted by the new dwellings facilities (Figure 5). Thus, if regarding the connection to electricity there is a relative balance between the two areas, the water and heating installations are more present in the urban area than in the rural one.



Source: NISS data.

Figure 5. *Finished dwellings by type of installations they are endowed with in 2009*

Of course, as Ailenei (2001) shows there are many other gaps in the economic and social development of the rural areas compared to the urban areas, which make Romania's process of modernization and European integration difficult. The difficulty of the European integration of the rural area from Romania is further accentuated by the long tradition of dominance of the rural area in relation to the urban one (Constantin, 1996).

During the communist period the diminishing of this share was forced by various means, most often destructive. Not even the transition to the market economy managed to improve the situation as the urban – rural migration flows have surpassed the rural-urban ones in the last years, making the problem of the too large share of the rural area to block the structural changes absolutely necessary for the economic modernization and the process of European integration.

2. The Leader axis – the chance to improve the urban – rural ratio

The Leader axis is one of the four axes of the National Rural Development Programme. The aim of this axis is to improve local governance through the establishment and operation of local action groups (LAG). The

main objective of the axis is to start and operate the local development initiatives, while the strategic objectives derived from the main objective are:

- to promote the endogenous potential of the territories;
- to improve the local governance.
- Actions to be taken under Axis 4, using three measures, can be summarized as follows:
 - Measures 41 and 421, through which local development strategies are implemented by the LAG, in selected territories, allows the achievement of axes 1, 2 and 3 objectives of the EAFRD, in accordance with the locally developed strategy, which materializes through projects made individually or in collaboration with other LAGs/partnerships.
 - Measure 431, divided into two sub-measures, namely:
 - Sub-measure 431.1 supports the construction of public-private partnerships, building local development strategies and the preparation of the Local Development Plan in order to participate in the selection of LAGs;
 - Sub-measure 431.2 provides the LAGs with support for: running costs, acquiring skills and animating the territory.

Analysing the social, economic and geographical, territorial coherence and homogeneity, relative to the number of inhabitants and the eligible area, the financial allocation envisaged for the Leader axis and the interest of local actors, the Ministry of Agriculture and Rural Development estimated that, following the selection procedures, a number of 80 LAGs can result.

Thus, the area eligible for Leader comprises a population of about 11.7 million, of which about two million came from small towns up to 20,000 inhabitants.

An interesting correlation concerning the LAG's potential is described by Ailenei (2011c).

The authors set up a database of our research, gathering information on all the 111 selected LAGs: the projects eligible values for phase values 431.1, the localities and the scores of the four selection criteria, the values of the development index of communes and the population of localities included in the LAGs. Based on this information an econometric correlation between the amounts allocated to LAGs, the total population of each LAG and the development index of communes was tested.

The low value of correlation is explained by using as dependent variable only the eligible amount in this preparatory phase (431.1). However, it is worth noting the negative coefficient associated with the development index of communes, which shows that the number of LAGs is high especially in poorer

areas of Romania. In contrast, the reduced influence of the total population seems to be paradoxical given that one of the four selection criteria relate to the population of the LAGs. It seems that the eligible amount is rather linked to the type of economic project around which each LAG is constructed, than to the size of its population, even if the impact factors of project implementation should consider this aspect.

3. Conclusions

Given the analysis presented above, it can be concluded that local action groups may represent a real opportunity to develop rural areas of Romania and implicitly to revitalize small towns included in such structures. Moreover, this programme could be a viable solution to reduce the excessive weight of the Romanian rural area, if it would continue over on the medium to long run, beyond the current period of budgetary implementation of the National Rural Development Programme.

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Post-crisis Economy of the European Union in the Global Context

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Abstract. *The recently economic crisis represents a new global economic turn. The question is whether, besides the necessary tools and actions to get out of the crisis, additional policies are needed on medium and long term to prevent a future crisis. In this essay I try to give some answers, integrating into the analysis both global and European levels, highlighting the necessary policies and their features in the Economic and Monetary Union and in the ex-socialist Central and Eastern countries, members of the European Union.*

Keywords: solutions and strategies to the economic crisis; the micro and macro-prudential supervision and regulation; fiscal consolidation of the financial sector and the sustainability of the public finances; the new institutional framework of the European Union; the Warsaw Consensus.

JEL Codes: E02, E63, O11, O12.

REL Codes: 20B, 20H.

1. Pre-crisis economy

1.1. Pre-crisis consensus

I will begin with a description of the pre-crisis consensus related to monetary policy, fiscal policy, and financial regulation.

Regarding monetary policy, low and stable inflation was considered the primary mandate of central banks. The theoretical framework was given by the New Keynesian model, which says that constant inflation is the only optimal policy choice for keeping economic growth at its potential rate. Therefore, keeping inflation at low and stable levels was the best method to ensure the optimal performance of the economy.

Regarding fiscal policy, it was considered secondary to monetary policy, for many reasons: skepticism about the effects of fiscal policy, based mainly on Ricardian equivalence explanations; concerns about temporal lags and political influences in the implementation of fiscal policy; the need to stabilize and reduce high debt levels; automatic stabilizers were considered sufficient to respond to changes in the economic cycle.

Regarding financial regulation and supervision, the focus was on the soundness of individual institutions and markets, and aimed at correcting market failures resulting from asymmetric information. Other macroeconomic implications of financial sector risks were ignored. Taking into consideration the great enthusiasm of financial deregulation, the use of prudential rules for cyclical purposes was considered as an inadequate interference in the credit markets functioning.

For about a quarter century, this macroeconomic framework seemed to work properly. The “Great Moderation” involving declining output volatility and moderate inflation, made us believe that the world knew how to conduct the macroeconomic policy.

1.2. What we have learned from the crisis?

Then the crisis came, which revealed the weaknesses of the pre-crisis consensus. The crisis has shown us that threats to macro-financial stability may develop beneath an apparent tranquil situation of stable prices, reduced output gaps and healthy public finances.

The crisis has also shown us that financial regulation can have a major macroeconomic impact. Regulatory weaknesses, including the regulation and supervision areas, allowed major risks to build up, enabling the explosion of the United States housing bubble to transform into a global crisis.

So, even if many ideas of the pre-crisis consensus remain valid (as low inflation and fiscal discipline), others need to be reconsidered. The crisis has also demonstrated that macroeconomic policy must have many targets. Fortunately, the crisis has also reminded us that we have many instruments to reach them.

The crisis has also emphasized the role of international policy cooperation. During the crisis, unprecedented cooperation allowed us to avoid another Great Depression. In the post-crisis period, such cooperation is necessary required to create the policy framework to support strong and stable economic growth.

1.3. The current juncture...

From an economic point of view the crisis has shown that we live in a multi-polar world. The crisis has affected the entire global economy, but the speed of recovery differs, with the United States and Europe still struggling while Asia and Latin America started to grow much earlier and at a faster speed. The de-coupling between the emerging and the advanced economies has taken place, but this doesn't mean that there is less interdependence. The explanation is that there can be autonomous poles of growth in the world economy.

From a financial perspective, the world is not yet multi-polar because of the different stages of development of various regions, which shows why the dollar is still the most used currency worldwide. This is the result of the decision of countries and market participants to use the dollar as a means of exchange, unit of account and store of value, and not the result of decision by the United States to impose the dollar on other countries. The crisis has shown that the dollar maintains its safe status, status unlikely to change soon.

Meanwhile, the Euro, as a result of the economic weight of the Euro area and of the stability of its currency, has become the world's second most important currency. But the Euro lacks some of the American dollar characteristics, such as the depth and liquidity of its markets or the existence of a major financial centre. The recently debt crisis in the Euro area has underlined these shortcomings.

In the case of other important players, such as China, the financial development is lagging behind their economic development. The renminbi is not convertible and the Chinese financial system is subject to multiple controls. A process of liberalisation has started but it will take some time before China will achieve the financial sophistication of the advanced economies. The progress would make the international monetary system more balanced.

This imbalance implies that the dollar-denominated financial market will remain important in the next years, in spite of the emergence of new economic powers in Europe and in Asia. This is the result of the slow speed of financial development and integration of Europe and Asia.

From a policy perspective, the world is far from being multi-polar. Many countries in Asia and the Middle East do not have independent monetary policies, but rather “import” their monetary policy from the United States by pegging their currencies to the American dollar.

So, we have a multi-polar economic world, but no multi-polar financial or policy world yet. This asymmetry is cause of the misallocation of resources at global level, which results in misalignments of asset prices, such as the exchange rate, and producing policy incentives which lead to sub-optimal results at national and global level.

1.4. ...and its consequences

Taking into account the above, I will briefly analyze a few examples of distortions and disincentives.

First, the existence of one major reserve currency leads to exchange rate fluctuations, conducting to abrupt shifts in risk aversion, rather than to changes in economic fundamentals, exacerbating longer-term imbalances instead of correcting them. The appreciation of the dollar after September 2008 is a example of this and has been one of the factors in the slow recovery of the United States.

Second, the lack of independent monetary policies and the peg of relevant countries to the dollar affect the exchange rate of third currencies. For example, the peg of Asian currencies to the dollar has distortiond the exchange rate of those countries which have a flexible exchange rate system against the dollar.

Third, the limited diversification of reserve currency assets limits the scope for markets to discipline macroeconomic policies, dragging out the financing of unsustainable imbalances which may turn into a crisis. The ease with which the United States has been financed its external deficit has conducted to prolonged unsustainable imbalances and delayed the policy adjustment necessary to increase national savings.

Fourth, the insufficient adjustment or the overshooting of exchange rates may conduct to disorderly policy reactions and encourage beggar-thy-neighbour policies.

2. Post-crisis economy

2.1. The way forward

Taking into consideration the above conditions, how can the functioning of the international monetary system be improved? There is a twofold strategy.

The first strategy is to build a new institutional framework designed for this new multi-polar world. This type of cooperative framework would manage the multiple interactions between the main economic powers and their effects on the global markets, both in normal times and at times of crisis. Even in a complete multi-polar world financial markets will be characterised by instability, overshooting and self-fulfilling expectations. No matter the number of economic powers, there must exist a forum to bring together the responsible for monitoring market developments, assessing underlying conditions and intervening to counter instability. This will require a G3, G4, G5 or more, depending on the number of relevant players. They are needed in particular in order to manage highly sensitive issues such as exchange rates, address major financial market instabilities and be able to act quickly and in a coordinated way. Such groupings will not substitute for stronger multilateral institutions, such as the International Monetary Fund or the G20. The larger is the number of power centres, the greater is the need for an independent assessment of the policies pursued by each of them and their impact on the others.

The second strategy implies the implementation of policies consistent with the transition to a more complete multi-polar world, taking into consideration all its dimensions. This involves a speedier shift to an independent policy framework in Asia, especially in China, with a progressively more flexible renminbi. The international community should convince the Chinese authorities that there are considerable gains for the Chinese economy, even though some protected sectors, currently subsidised by the currency peg, might lose out in the short term. The experience of Japan and Germany in the 1970s has shown that a country can remain a strong exporter with a strong currency.

A more balanced multi-polar world also requires a deeper financial and economic integration in Europe, particularly in the Euro area. This involves addressing some of the uncertainties and inefficiencies affecting the current institutional framework underlying the Euro. It is necessary for the euro to be a key pole in the emerging new world that policy-makers in Europe look at the current problems not only from a closed-economy perspective; they also must be able to explain the advantages of being a global player. If Europe cannot find its place in the new multi-polar world, it will be squeezed between the other centres of economic power, and will suffer from their spillovers.

2.2. How to face the challenges: from global to local

Now I'm going to focus on three key areas that characterize the reform agenda.

First, macro-prudential supervision must be strengthened. This includes the global monitoring of systemic stability and the supervision of systemically important cross-border institutions, while properly addressing interlinkages among themselves, with other financial and non-financial institutions and markets. Therefore, one step was made by the broadened mandate and stronger institutional basis was given to the Financial Stability Board. The G20 Leaders, together with the Bank for International Settlements, re-established the Financial Stability Board, in order to develop macro-prudential tools, to identify the macro-prudential risks across the financial system and in order to limit the build up of systemic risk for regulated entities. In addition, the cooperation between the International Monetary Fund and the Financial Stability Board for the conduct of Early Warning Exercises will be crucial for the success of the global monitoring of systemic risks.

Second, we must undergo the global regulatory and supervisory repair. The Basel Committee has already set some milestones in this regard including the publication of the principles for sound liquidity risk management and supervision and its current work on strengthening the Basel II framework. The Basel Committee is developing proposals for countercyclical buffers. Some other important strands of work of the Basel Committee to strengthen the resilience of banking systems, are: a) the introduction of a non-risk based supplementary measure, b) strengthening the quality of banks' regulatory capital and the review of the minimum level of regulatory capital with the aim to arrive at a total level and quality that should be higher than the current Basel II framework (the importance that increases in the minimum regulatory capital, as a result of the aforementioned initiatives, should not take place in periods of economic and financial stress).

Third, regulatory gaps need to be closed. Therefore, the G20 Leaders endorsed the extension of the regulatory net to all systemically important institutions, markets and instruments. These include important hedge funds, credit rating agencies and over-the-counter derivatives markets.

2.3. European Union

Regarding to European Union, it is important to build the notable achievements and stable foundations of the single monetary policy.

The credibility of the European Central Bank rests on its independence, the transparency of its strategy and the consistency of its words and actions. Euro area's new surveillance framework must be built on these three principles of independence, transparency and consistency.

2.3.1. The achievement of price stability in the Euro area

The European Central Bank's single objective is the one of price stability (the annual inflation in the euro area below of 2%, but close to 2%, over the medium term).

Since its establishment in 1998, there were 12 years of low inflation and low interest rates. The average annual inflation rate in the euro area has been 1.97% being the best result in terms of price stability for any large Euro area country over the past half a century. As a result, millions of Europeans had preserved their purchasing power and the value of their savings.

The steady course of monetary policy also contributed to stabilize medium to long-term inflation expectations at a level consistent with price stability, despite the numerous economic and financial shocks that European Central Bank had to face.

One important fact that these achievements have not come at the expense of employment. On the contrary, since Economic and Monetary Union began, employment in the euro area has risen by over 14 million. More important is that these achievements have not come at the expense of economic growth either. Adjusted for population growth differences, growth in the Euro area has been about 1% per year in terms of gross domestic product per capita growth, over the past decade.

2.3.2. Responding to the crisis: bold actions in line with steadfast policy orientation

All these achievements have been possible due to the actions that have been taken in the medium-term oriented monetary policy strategy.

The financial crisis has changed neither the strategy, nor the objective. The European Central Bank's response to the crisis has always been connected with the strategy and medium-term objective of price stability.

The European Central Bank also have broaden the range of tools to adapt monetary policy to the challenges of the crisis, ensuring the euro area banks against present and future liquidity shortfalls. Banks are very important to the financial system: 70% of firms' external financing comes from banks. Therefore, banks finance a very large share of the investments made in Europe.

The lack of banks' ability to lend would have meant jeopardising the jobs of millions of Europeans.

Yet, monetary policy responsibility can not substitute for government irresponsibility through excessive government borrowing leading to a rise of the government paper market. This market has a central role in the financial system and constitutes an important element in the transmission of monetary policy to the real economy. Therefore, the European Central Bank had alerted all governments that they had to correct drastically their fiscal policies and restore fiscal sustainability with no delay.

2.3.3. The need for a rigorous and credible surveillance framework

So the period ahead is about two things: fiscal consolidation and measures to strengthen the growth potential of the economies. These need to be monitored by a credible and rigorous surveillance framework.

At the moment there are different points of views about the concrete design of the new surveillance framework.

Regarding the European Central Bank's view on such a framework for fiscal policies, three elements are indispensable: a) shorter deadlines under excessive deficit procedures; b) quasi-automatic application of sanctions; c) ambitious targets for the reduction of public debt towards the 60% of gross domestic product ceiling.

The severity of the breach should determine the severity of the sanction. Therefore, fines, reduced access to European Union funds, and other pecuniary sanctions are necessary.

There should be inflexibility in applying sanctions if rules are breached. This implies that decisions are necessary for the sanctions to be credible. Decisions only will give national policy-makers the right incentives. This is called quasi-automaticity.

There should be greater focus than ever before on government debt levels, more automaticity, improved national fiscal rules and better statistical data.

Regarding the European Central Bank's view on such a framework for macroeconomic policies, national developments of prices and costs must take into consideration that it is a union of monetary stability. This implies that national price and cost developments that are higher than the union average implies considerable losses of competitiveness, losses that cannot be sustained forever; therefore, this requires adjustments in the unsustainable economic policies. Fiscal and structural policies have to keep domestic demand in line with rates of sustainable growth and price stability.

A new framework for monitoring macroeconomic policies requires: a) a limited number of defined quantitative indicators to identify undesirable developments; b) transparency about the procedures and the sanctions; c) and a set of reliable statistical data, interpreted by independent arbiters.

A specific scoreboard should be designed for every Euro area countries.

Credibility of the analysis is the key. The credibility of the European Central Bank stands on its independence and transparency of the chosen strategy and consistency. Europe's new surveillance framework must be built on these principles: a) of independence in the assessment of the fiscal situation as well as of the soundness of macroeconomic policies; b) transparency of the procedures; c) consistency.

2.3.4. The way forward

The Euro area and the European Union requires some initiatives in key areas in order to guarantee the public authorities' ability to continue delivering macroeconomic and financial stability. The components of plan of reform for Europe are the following: a) implementing fiscal consolidation and securing the sustainability of public finances; b) promoting sustainable growth and job creation; c) enhancing the crisis management framework; d) strengthening the financial sector.

2.3.4.1. Implementing fiscal consolidation and securing the sustainability of public finances

The financial and economic crisis has led to a deterioration in the fiscal positions of Euro area countries, in terms of large budget deficits and rising government debt. The economic recession amplified imbalances in fiscal policies that had built up gradually long before the crisis, reflecting the failure by many countries to implement sound fiscal policies during past periods of strong economic growth. On the institutional side, the European Union's fiscal framework, embedded in the Stability and Growth Pact, proved to be too weak to enforce fiscal discipline and was not implemented with sufficient rigour.

However, the need to pursue more ambitious consolidation targets is more general. Fiscal consolidation is essential to ensuring an environment conducive to output growth and price stability.

Looking ahead, implementing fiscal consolidation and securing the sustainability of public finances are among the major challenges faced by policy-makers. The consolidation of public finances requires a comprehensive policy comprising: (i) the timely correction of excessive deficits; (ii) the

reduction of government debt to more sustainable levels; and (iii) the reorganisation of banks in order to limit strong links between the balance sheets of governments and financial sectors, which typically result in the socialisation of banks' liabilities in times of crisis. These measures need to be complemented by pension and healthcare reforms to alleviate the fiscal burden arising from population ageing.

Moreover, fiscal governance in the Euro area needs to be reinforced by means of the strengthening of the Stability and Growth Pact. This means establishing stricter and more binding rules for fiscal policy, backed up by stronger sanctions or mechanisms to ensure compliance with the rules. At the same time, the effectiveness of budgetary institutions needs to be improved at the national level. In this context, effective rules on expenditure should be regarded as a means of promoting fiscal discipline and limiting fiscal vulnerabilities in the event of adverse economic shocks occurring in the future.

2.3.4.2. Promoting sustainable growth and job creation

Euro area countries also need to increase their efforts to strengthen their growth potential and their ability to create jobs in a sustainable manner. European countries have made reasonable progress over the past ten years in the area of employment. Indeed, over 14 million jobs were created in the Euro zone since the introduction of the Euro, far more than in the previous ten years (around eight million). The employment increase in the Euro area since 1999 was even significantly larger than in the United States (7.6 million).

This is an important achievement, but it remains insufficient, especially against the background of the massive employment destruction observed in some Euro area countries during the crisis. Unemployment rates have reached unacceptably high double-digit rates in some countries and segments of the population (i.e. the young workers), that, as a result, carry extremely large economic and social costs. This is socially unfair and economically inefficient.

European countries must make more efforts to resolutely pursue – and with far greater urgency than in the past – the necessary structural reforms in product markets, labour markets, pension systems and so on. In this respect, a key contribution to the strengthening of the Euro area's long-term economic prospects will come from the thorough implementation of the Europe 2020 strategy, with its focus on key areas such as: (i) education, research and innovation; (ii) resource efficiency; and (iii) high levels of employment and social cohesion.

2.3.4.3. Enhancing the crisis management framework

In response to the sovereign debt crisis, the Euro area has recently armed itself with an important tool to safeguard area-wide financial stability. At the European Council meeting of 24 and 25 March 2011 the Heads of State or Government of the European Union agreed to establish a permanent European Stability Mechanism based on the existing temporary European Financial Stability Facility (which will remain in place until June 2013).

The European Stability Mechanism will grant financial assistance to countries in distress in the form of credit, with the assistance provided under strict conditionality and on the basis of a strict analysis – conducted by the European Commission and the International Monetary Fund, in liaison with the European Central Bank. The establishment of the European Stability Mechanism represents an important addition to the institutional fabric of Economic Monetary Union.

However, the existence of a mechanism to provide financial assistance to countries facing temporary distress should not be seen as a source of moral hazard. Such risks are prevented both by the strict conditions under which any assistance would be provided and by the fact that the mechanism will be activated only if deemed indispensable in order to counter threats to the financial stability of the Euro area as a whole. In addition, the establishment of this permanent stabilisation mechanism will be accompanied by the strengthening of the framework for economic governance in the Euro area, particularly as regards the framework for the multilateral vigilance of national policies in the areas of public finances and competitiveness.

2.3.4.4 Strengthening the financial sector

The financial crisis has also revealed a number of deficiencies and vulnerabilities in the regulatory and supervisory frameworks in the economies. The massive economic and financial impact of the crisis has clearly indicated that addressing such deficiencies through far-reaching reforms is essential in order to prevent similar crises in the future.

In Europe, important steps have been taken with a view to addressing the long-standing friction between, on the one hand, the international dimension of the operations of commercial banks and financial institutions, and, on the other hand, the national boundaries that constrain regulatory and supervisory measures. The Heads of State or Government of the European Union have agreed on a new structure for financial supervision in the European Union – the

European System of Financial Supervision – with a view to improving coordination and cooperation.

As regards micro-prudential supervision, three newly established European Supervisory Authorities for banks, insurance companies and financial markets became operational at the beginning of 2011. These are designed to enhance coordination between micro-prudential supervisors and to ensure the application of European Union wide standards in the area of technical supervision.

In addition, a new authority – the European Systemic Risk Board – has been established with a mandate to conduct macro-prudential supervision within the European Union.

2.3.4.4.1. Macro-prudential risk monitoring and assessment

The first component of strengthening the financial sector is enhancing the capacity of public authorities to identify and address systemic risk at the European level, both from an analytical and an institutional perspective.

Prior to the crisis, the lack of an institutional mechanism to translate the financial stability analysis made by central banks and the European Central Bank into policy actions was a major lacuna. In response, the European Systemic Risk Board has been set up to monitor and assess macro-prudential risks. Given that the new framework began operating in January 2011, it is difficult to assess its effectiveness comprehensively.

But the purpose of the European Systemic Risk Board is not to predict crises. The academic literature on early warning signal models, developed over the years, suggests that, for a number of reasons, the scope for error predicting in crises is substantial. Either the eruption of a crisis is missed or a period is wrongly identified by the start of a crisis. For this reason, the European Systemic Risk Board's analytical toolbox is based on early warning models and indicators designed to identify emerging vulnerabilities or imbalances that could lead to financial instability.

These models aim to perform three functions in particular.

First, to identify the variables which are associated with financial instability. To this end, an index of aggregate macro-financial imbalances, or of institution-specific vulnerabilities, is tested against variables such as credit growth, property price changes, private sector leverage and current account deficits, to discover which variables predict that index. Measures of bank leverage, balance sheet growth and maturity mismatches may also be used in order to gauge the extent to which the financial sector is developing.

Second, to assess the relative importance of different risks for financial stability. This is done using “adverse scenarios” that are designed and stress-tested to establish the potential severity of different types of risk and the overall resilience of the financial system to severe shocks. Such models, including top-down stress test of individual institutions, allow risks to be assessed more broadly and at a higher frequency than is possible with bottom-up exercises run by financial institutions, thus enhancing the “real time” information on systemic risk available to policymakers.

Third, to assess the financial channels through which risk can be propagated. The use of contagion and spillover models allows, for example, the assessment of the impact on the financial system of the failure of a particular financial institution or of turbulence in a particular sovereign debt market.

It could be considered how this framework would have functioned if applied retrospectively. For example, the monitoring of the credit-to-gross domestic product ratio as an early warning indicator of widespread asset-price misalignments would have initiated early warning signals as early as mid-2005. If the European Systemic Risk Board had been operational at that time, a risk warning would have been issued drawing attention to substantial price misalignments in mortgages and equity prices. Corrective measures could then have been recommended to curb credit growth, potentially distinguishing across countries depending of the magnitude of the imbalances. If followed, these policy measures could have deflated the asset price bubble before its dramatic burst in 2007.

This example suggests that the analytical framework employed by the European Systemic Risk Board could significantly strengthen macro-prudential risk assessment.

Ultimately, the effectiveness of the European Systemic Risk Board’s recommendations will depend on the quality of the analysis behind them. Macro-prudential authorities will have to justify concrete policy changes, and so their analysis must be beyond reproach. For this reason, in order to support the work of the European Systemic Risk Board, the European Central Bank is in a process of enhancing its analytical tools with regard to risk surveillance and assessment. The European Central Bank has now operational models and tools to fulfil the three functions previously mentioned and continues to work hard to improve them.

2.3.4.4.2. An European framework for micro-prudential supervision

A more comprehensive European-wide understanding of systemic risks needs to be complemented by an effective micro-prudential supervisory framework to monitor and prevent these risks. This implies a more consistent set of regulatory and supervisory rules across Member States, together with

stronger rules and practices for cooperation between supervisory authorities on cross-border groups, both in normal and crisis situations.

In this context, the European Supervisory Authorities have been allocated a significant set of competences related to rule-making, enforcement of rules and coordination of supervision. Through these tools, the European Supervisory Authorities are expected to develop a single “European Union rulebook” which has to be enforced consistently throughout the whole single financial market. This should address a major weakness in the current framework, namely the divergences across countries in key regulatory elements – for example the different components of regulatory capital used across member states.

Furthermore, the European Supervisory Authorities have the power to take legally binding decisions addressed to national supervisors or, in case of non-compliance, to specific financial institutions if warranted by financial stability considerations. These powers can be triggered by a breach of European Union law by supervisors; disagreement between national supervisory authorities in cross-border situations; and the declaration of an emergency situation by the Council. However, in the latter two cases the European Supervisory Authorities’ powers are subject to the “fiscal clause”, which provides that the European Supervisory Authorities’ powers cannot impinge on the national fiscal responsibilities.

I have described the way forward for the Euro area economy. However, I haven’t considered some of the “shortcuts” that, according to some economists are supposedly available to countries unwilling to bear the costs of structural and fiscal reforms. In particular, it is often argued that Greece would be better off rescheduling or renegotiating some of its sovereign debt, rather than continuing to implement the adjustment programme negotiated with the international authorities as part of the financial assistance provided by the European Commission and the International Monetary Fund.

The argument is typically presented as follows: “Greece’s key problem is not a temporary lack of access to liquidity, but rather a solvency crisis. The country is too weak to bear the economic and social costs of implementing the institutional and economic reforms foreseen by the adjustment package. The country may, therefore, be better off announcing some form of renegotiation or restructuring of its debts with private creditors. Of course, such a step should not be taken lightly, since it may be tantamount to a sovereign default, and the economic literature suggests that the costs of defaults can be both multiple (reputational loss, exclusion from financial markets, trade sanctions, and so on) and substantial.

2.3.5. The new growth model – The Warsaw consensus

Given that the global crisis has undermined the credibility of the current growth model, the ex-socialist Central and Eastern countries, members of the European Union, will need to adjust its growth strategy to accelerate post-crisis growth rates and better insulate the region from outside shocks.

This applies to the Baltic States, Bulgaria and Romania, which were hit hardest by the crisis, but also to the Czech Republic, Slovenia and Slovakia, which despite having maintained macroeconomic discipline before the crisis, suffered more than countries at comparable levels of development in other parts of the world. Even Poland, which avoided the recession, is projected to develop slower in the medium-term than many high-achieving emerging markets such as Korea, Singapore, Malaysia, Mexico and Brazil.

There is therefore a need to develop a new growth model. This could be called the Warsaw Consensus in order to reflect the large economic role of Poland in the region, with a 40% share in the ex-socialist Central and Eastern countries, members of the European Union income, its successful post-1989 political and economic transition and the way it managed the global crisis.

The Warsaw Consensus should be based on the best features of the pre-crisis development model – openness to trade, capital inflows and movement of labor, high quality of human capital, a common European Union institutional framework, low social inequalities, attention to social values, well-being and quality of the natural environment – and on the best characteristics of the Asian development model high savings, diversified exports, mixed ownership, conservative financial markets, strong financial supervision and controlled real exchange rate appreciation.

The Warsaw Consensus has to be different from growth models for other parts of the global economy. This is largely because of the unique characteristics of the region: its common post-socialist background, medium level of economic development and, above all, its location in the middle of Europe, along with its European Union membership.

Moreover, these countries could not follow other growth models: the neoliberal Washington Consensus is viewed in many quarters as discredited as a result of the recent global crisis; the Beijing Consensus, based on the Chinese strategy of development, would not apply to these countries, given their democratic credentials, increasingly service-oriented economies and European Union membership; and the Mumbai Consensus, reflecting the unique characteristics of the Indian growth model, is likely to be of interest only to developing countries at a much lower level of development. Finally, these countries could not fully follow what could be called the Berlin Consensus, a

set of economic principles, which have worked well for Germany, especially in the past decade, but would need to be adjusted to reflect different levels of incomes and the likely divergent development paths of the poorer the ex-socialist Central and Eastern countries, members of the European Union.

The Warsaw Consensus would be based on the following ten pillars: 1) high domestic savings; 2) high employment rate; 3) high labor productivity growth; 4) controlled real exchange rate appreciation; 5) labor markets open to immigration; 6) strong financial sector supervision; 7) efficient use of European Union funds; 8) further European Union integration and enlargement; 9) diversified exports; 10) focus on well-being and quality of life beyond gross domestic product.

2.3.5.1. High domestic savings

The issue: the ex-socialist Central and Eastern countries, members of the European Union, do not save enough to support high investment rates and help insulate them from future crises by lessening reliance on imports of foreign capital.

The solution: raise private and public saving through second and third pillar pension reforms; higher effective retirement ages; stricter domestic and European fiscal rules, including introduction of constitutional debt limits; pan-European tax harmonization and establishment of fiscal councils to monitor the fiscal situation; and increased transparency. In addition, adopt the Euro at a competitive exchange rate. The target should be for the domestic savings rate to amount to at least 25% of gross domestic product, up from around 20-21 % currently. Together with imported savings of up to 5% of gross domestic product, mostly in the form of foreign direct investment, this should allow domestic investment to amount to least 30% of gross domestic product, in line with the high investment ratios experienced in the past by successful catch-up countries, such as Japan, Korea, Singapore and Taiwan.

2.3.5.2. High employment rate

The issue: despite substantial improvements in the last two years, the average employment rate among 20-64 year old amounted to 67% in 2009, below the 75% target of the EU 2020 Strategy.

The solution: the raise of effective retirement ages; streamline access to disability pensions; guarantee the right mix of skills through education reforms and lifelong learning, especially for older generations; and develop insurance instruments to help finance re-skilling and job search. The goal should be to

raise the employment rate to the 75% target of the EU 2020 Strategy by 2020, boosting economic growth and helping to stabilize public finances.

2.3.5.3. High labor productivity growth

The issue: insufficiently high growth in total factor productivity.

The solution: increase total factor productivity growth to at least 2% per year by fully opening domestic and European Union markets to competition, particularly in the utilities and services sectors; promote labor immigration, especially among high-skilled workers; improve business climates; promote export-sector foreign direct investment; enhance human capital and labor skills through further educational reforms and lifelong learning; increase the efficiency of public administration, including through the introduction of e-government; reform public research and development institutions; and increase the value and efficiency of public spending on technology absorption and innovation.

2.3.5.4. Controlled real exchange rate appreciation

The issue: uncompetitive exchange rates before the crisis led to unsustainable asset booms and reallocation of resources from export-oriented sectors toward other sectors, mainly real estate, which undermined growth and the stability of the balance of payments.

The solution: following in the footsteps of all previously successful catch-up countries, including Japan, Korea, Taiwan and Singapore, EU-10 countries should ensure that wage growth never exceeds growth in labor productivity. This should be done through maintaining labor market flexibility, opening labor markets to migration, controlling increases in public wages and implementing active fiscal policies.

2.3.5.5. Labor markets open to immigration

The issue: Impending demographic decline and population aging, which undermine economic growth and the stability of public finances.

The solution: Given that pro-natalist policies, while important, would be insufficient to raise fertility ratios to replacement levels, the ex-socialist Central and Eastern countries, members of the European Union, should fully open its labor market to immigration, re-attract their citizens working abroad and actively promote migration inflows, especially among high-skilled workers from Eastern Europe.

2.3.5.6. Strong financial sector supervision

The issue: insufficient control over excessive credit growth, leading to asset booms and financial instability.

The solution: strengthen supervisory control over foreign banks operating in the region – which hold the dominant share in the region's banking sector assets – through domestic and European Union-wide anti-cyclical macro-prudential policy; limit foreign currency borrowing; close cooperation with financial supervisory authorities in home countries; emphasize conservative business models.

2.3.5.7. Efficient use of European Union funds

The issue: Incomplete utilization of the available European Union funds; insufficient efficiency in spending.

The solution: Ensure full utilization of the available European Union funds, particularly in lagging countries, such as Bulgaria and Romania, and increase their efficiency by spending it on infrastructure, human capital development, technology absorption and innovation.

2.3.5.8. Further European Union integration and enlargement

The issue: incomplete integration of the European Union product, service and labor markets; pause in the enlargement process.

The solution: promote all European Union-wide initiatives, such as the most recent "Pact for the Euro", that aim to achieve a real integration of the European Union's product, service and labor markets and increase the European Union's competitiveness; argue for continued European Union enlargement, which brings economic benefits to both old and new members.

2.3.5.9. Diversified exports

The issue: too narrow focus on the European Union export markets, which weakens growth potential and increases the risk of economic instability.

The solution: rebuild economic ties with emerging markets, including the BRICs (Brazil, Russia, India and China), increased financial support and the introduction of partnership agreements promoting foreign direct investment inflows into the region from non-European Union countries, in exchange for

access to their domestic markets. The long-term target should be for the share of non-European Union oriented exports to represent at least one-third of the total, up from less than one-fifth currently.

2.3.5.10. Focus on well-being and quality of life beyond gross domestic product

The issue: excessive focus on gross domestic product as a measure of social and human development.

The solution: focus strategic economic policies not only on expanding gross domestic product, but also on promoting well-being, including life expectancy, educational attainment, quality of governance, quality of natural environment, level of personal freedom, safety and security, availability of leisure time, public trust and strength of social networks.

Full implementation of the Warsaw Consensus should allow New Europe to accelerate post-crisis growth rates and to better insulate the region from future global and regional economic shocks.

Conclusions

The international community is working towards a post-crisis financial architecture that gives more prominence to having a strong macro-prudential orientation, is based on strengthened regulatory and supervisory frameworks, and prevents regulatory arbitrage. It is now important to keep the momentum in the implementation of the ongoing global initiatives.

Effective coordination of all policy initiatives is the key for ensuring global consistency and success; but financial stability ultimately depends on the implementation of global initiatives at the local level. Sound regulation, supervision and governance of financial markets are key parameters on the way towards a financial architecture that will pass the test of time. In this regard, it is now time to build for the future.

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New Approaches to Social Economy

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Abstract. *Social economy is a relatively new phenomenon, having started just a few decades ago, and due to this reason it has yet to reach great scale. Due to the phenomenon of global crisis propagation, the economies of all countries have been affected and have gone into an economical cycle recession phase, some economical agents hitting the climax of the crisis, practically shutting down their activities. Starting from this, some social problems started to accentuate: the number of unemployed people has risen, the poverty rate went up, the marginalization and social exclusion rates went up, the aging of the population has increased, the discrepancy between the rich and poor has widened and so on, and in this context social economy has gained a greater importance not only at an European level but also at an international level. As such, social economy may become one of the innovative and creative solutions which can contribute to a more human approach to economical problems, combining freedom of market with social responsibility to the benefit of the whole community.*

Keywords: social economy; social enterprise; professional insertion.

JEL Codes: A12, A13, A19.

REL Code: 6E.

The term social economy is not a new term but the manifestation of the phenomenon has begun some decades ago. The term itself first appeared in the year 1830, when the French economist Charles Dunoyer published a social economy treaty in which he pleaded for a moral approach to economy⁽¹⁾.

Social economy built itself as a mechanism by which different groups with similar jobs could help each other, arranged as cooperatives or similar need groups, built as mutual help societies or house unions, and groups with similar aims, built as associations and foundations. In fact, these are the forms under which social economy manifests, which have diversified in time and have attained quite some size at a whole society level.

After the Second World War, there was a period of economical growth geared towards a welfare state and, as such, social economy had limited role on the market. In the past 20 years social economy has begun to take shape and greater meaning due to the accentuation of social problems, not only at an European level but also at a global level: unemployment rates have risen, poverty rates have risen, so have social marginalization rates and so on. The welfare state, which up till then had the capacity and resources to provide adequate and diverse social services, finds itself all of a sudden confronted with a series of important challenges and sees itself overwhelmed by the size of economical and social events. All these have put great pressure on the social protection statist systems and in such a case, social economy started to become a solution to tackling social and even environmental problems.

Though there is no concise and unanimously accepted definition to social economy, those engaged in social economy try to define social economy through economical and social criteria or by making use of social economic principles.

If we try to define social economy by relating to economical criteria, we could say that: social economy is the economical activity which produces goods and services with the purpose of improving the living standards of the community and which provides a high degree of autonomy, a significant degree of economical risk and implies a low volume of paid work, but also a high level of voluntary work from those which wish to be solidary towards the rest.

If we were to make use of social economy criteria, then we may define social economy as such: social economy is a private initiative, which takes upon itself the responsibility of guaranteeing an explicit purpose to the benefit of the community. Deciding power is not based upon capital owned, and instead all social economy participants are involved in the decision taking process, and again profit is not distributed to the owners of production inputs, but is invested again in other social actions of the social economy.

The principles of social economy are essential if we wish to have a correct definition; this way social economy implies: solidarity, responsibility, freedom, equal chances for all organization members, autonomous

administration and independence from public authorities, the interweaving of member interests with general interest and participation of all to the decision taking process, in a democratic way.

Over time and thanks to great changes which have taken place around the world, social economy has taken many forms and suffered series of transformations, differing from country to country, and, in this respect, if we observe what changes have occurred in Romania, we can distinguish some phases which point out its crisis and transformations: 1. the period before the First World War; 2. the inter-war period and a little bit after the Second World War; 3. the communist regime; 4. after the revolution from 1989 and until now.

In the first period of social economy's evolution, civic activities were few, donations towards the Orthodox Church were the main feature of the philanthropic behaviour, and the first regulation of the fundamental rights and freedoms for the development of the civil society was made in the First Romanian Constitution of 1866. After the First World War and the creation of Kingdom of Romania, the legal frame caught speed and on February the 6th of 1924, Law no. 21 (the Mârzescu Law) was adopted, law which created the legal frame necessary to apply the association principle mentioned in the 1866 and 1923 Constitutions, thus the number of associates and foundations significantly grew in the interwar period, but compared to the European average, the levels of associative life was still quite low⁽²⁾.

Social economy was reborn and knew significant evolution after the 1989 revolution, because after 1990 foundations and voluntary associations could be created without the permission of the Government, and the legal basis was offered by the Mârzescu Law of 1924, which was replaced with GO no. 26/2000, thus a clearer and more predictable legal framework in terms of the registration procedure was attained. As such, the number of organizations grew from 13.000 in 1999 to over 44.000 in 1996, to 53.000 in 2008, over 64.000 in 2009, and at the date of 18.10.2011 there were over 72.000 organizations registered⁽³⁾.

At a national level for 2011, you can see that most registered organizations are associations (74%), then foundations (24%), and a very small share of the total number of organizations is represented by federations and unions (1%). The number of associations is greatest because, on one hand, this is a marker of associatively, solidarity and inter-helping spirit, and, on the other side, the characteristics of organizations are more accessible as opposed to conditions of foundations (for example the existence of a minimum level of initial patrimony of 100 gross minimum salaries per economy⁽⁴⁾ as opposed to one gross minimum salary per economy in the case of associations, and there are other conditions too).

Promoting economy is an opportunity to address multiple essential needs at the same time, namely creating new work places, increasing social inclusion and increasing quality accessibility and social service efficiency. Social economy has

significant potential, but it requires a clear and concise legal frame which can spur the development of social economy entities. At this time, there is no social economy law and, because of this, it is not stimulated, although we do believe that it has considerable potential. Social economy is regulated in some bills, but each only encourage certain parts or social economy entities or, most of the time, the actors which wish to take part must make use of a series of artifices if they wish to function under the law and also to be able to function as agents of social economy.

In Romania, there is a manual of good practice inside which are showcased numerous associations and foundations which create work places for population categories which are discouraged by the labour market conditions and which had lost hope that things will change. To this end, we will present a few social economy entities which undertake economical activities with the purpose of producing goods and services with the help of disadvantaged members of society and to help them too.

The Horizons Charity Foundation (the leasing of greenhouses in the city of Câmpulung Moldovenesc so that vegetables, floriculture and green spaces maintenance may be undergone) have hired two individuals with mental disorders, and will hire ten more employees; in the Foundation for You (which offers social service to adults with mental disorders from Timișoara) the number of adults with disorders which got hired rose from 7 in 2007 to 45 in 2011; the Caritas Foundation of the Timișoara Diocese performs economical activities in domains such as milling, gardening and livestock rearing using 12 employees, former homeless individuals which come from the Pater Jordan doss house, which was opened in the year 2000, and they have also created 20 other work places for socially marginalized individuals coming from the doss house, as well as craftsmen from within the community, specialized in the domains of activity of the farm, performing electrician, plumber, locksmith and carpenter work; the Hope Association for protecting the AIDS positive from Constanța has created tens of work places for HIV positive individuals, they being hired part-time for activities created by the association: a micro farm and a greenhouse for gardening in a self-managed system; the Touched Romania Association of Bucharest has created 10 work places for mothers which raise their children on their own and which come from disorganized or dissolved families and are institutionalized so as to prevent infant abandon, the association producing two lines of jewellery made of semiprecious stones; the Alongside you Foundation of Iași has managed to create over 20 work places for vulnerable young people, hiring them to craft artistic decorative items, works of art and products specific to manual bookbinding; Future plus is the Association for durable development which offers an ecological alternative – the use of burlap bags instead of environmentally damaging plastic ones, the association hiring individuals in difficulty for periods of 6 to 18 months,

also offering them a training and professional counselling program; and there still are other examples of such⁽⁵⁾.

Even if, at first glance, the number of work places created by social economy is small, we can see in Table 1 regarding the evolution of the number of employees that this number is not negligible and that social economy has the potential to create even more work places, if there is a special political support for social economy. Currently the social economy is regulated but does not encourage its development because there is no clear legal framework, consistent and specific social economy.

As such, you can see from the balance sheet for 2009 that the total number of work places created through Social Economy was 163,354 spread across a total number of 25,744 organizations (Table 1).

Table 1

The evolution of personnel numbers which work in Social Economy for the year 2009

	Number of employees	Number of organizations
Associations and foundations	109,982	23,100
Employee credit unions	16,275	704
Pensioner credit unions	2,724	193
Handicraft cooperatives	25,553	788
Consumer cooperatives	7,401	894
Credit cooperatives/ Cooperative Banks	1,419	65
TOTAL	163,354	25,744

Source: data supplied by the NSI based upon data from the balance sheet of 31.12.2009 from the Ministry of Finance.

Conclusions

We believe that in a world full of envy, selfishness, a fierce struggle and individual interests, people distrust each other, etc. people are not happy, but rather the feeling of incompleteness end dimensions becoming larger. Involvement in community and voluntary action, self-help those who at one time are more vulnerable, from different reasons, and sometimes does not depend on their person, is a great feeling that cannot be explained in words but lived by direct involvement in acts of community service and social action

Between social economy and the labour market there is a relationship of interdependence for inclusion and that the social economy can be a continuation of employment policy, providing employment to all who are discouraged and can have up to you from seeking employment. The social economy creates jobs for people with disabilities, for those excluded and socially marginalized, those without a home, those who have no training, single parents, who are stigmatized and Roma fail to find a place work, young graduates entering the labour market becoming unemployed left, and all who are interested in the social economy values.

The issue of social economy should be reconsidered because it has a real potential for development and implementation in all spheres of economic and social life in this respect, it is found legal, the social economy so that all entities have the same operating conditions and production of goods and providing social services to all who want to make social economy.

Notes

- (1) CIRIEC (International Center of Research and Information on the Public, Social and Co-operative Economy, p.14, available online www.ciriec.ulg.ac.b.
- (2) Todor Ardad (2008), Civic Europe – Romania Civic Association Pro Democracy, edited and published material in Hungary, pp. 9-10, available online at www.apd.ro material.
- (3) The Ministry of Justice, National Register data from NGOs, www.just available online. en and published in pdf format, last updated 18/10/2011.
- (4) Economy gross minimum wage in the public sector is different from private, so in early 2011 the minimum level of public funding for paid staff is 720 RON and in private sector staff the minimum is 670 RON.
- (5) See more in Handbook of social economy in Romania and other European countries, Solidarity, a new source of economic power, published by the Ministry of Labour, Family and Social Protection, 2011.

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The Role of Accounting and Accounting Law in Establishing Public Economic Policies in the Post-crisis Period

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Abstract. *The following issues are being addressed in this paper: the relationship of accounting and accounting law with the local economy, the relationship of accounting and accounting law with macroeconomics, establishing public policies for certain categories of enterprises based on information provided by accounting and accounting law, the relationship of accounting and accounting law with macroeconomics foresight and forecast, the relationship of accounting and accounting law with the labor economy, the impact the wage regulations has on public economic policies under firm ownership change.*

Keywords: accounting; accounting law; public policies; macroeconomics; microeconomics.

JEL Code: M49.

REL Code: 14I.

1. Introduction

In most studies on overcoming the crisis, information mainly from macroeconomics is being used. Public policies are increasingly showing deficit due to lack of relevant information from the basic level of the company. At the same time microeconomics has basically evolved separately from the macroeconomics issues. Due to increased demands of managers and employers, accounting has evolved a lot lately and can provide useful information to ensure more performance for public policies. Accounting also generated a system of legal institutions that formed the accounting law, very helpful in understanding the correlations between the company's economy and other parts of the national or even global economy. This paper aims to draw attention to the information correlation between accounting and accounting law, on one side, and all the segments of the economic science directly involved in establishing economic policy, on the other side. The methods for public policies will be improved and accounting will receive new functions.

Any policy and any project achieves its objectives only if taking into account the real state reached, the exact coordinates of the starting point. The first objective of the economic growth policy is to establish long term development targets (Angelescu et al., 2009, p. 34). Accounting and accounting law gives us accurate information on the economic situation of companies, major funders of public policy and, in the same time, information on the main agents on which the implementation of public policies is dependent. The accounting information system is the most complete and accurate information tool available to society at the beginning of the XXI century. Based on it even data of public interest regarding corporate activity can be obtained. Without taking into account information from the accounting system, public policies will lose realism, which primarily means the risk of an efficiency level below expectations. A lower efficiency will mean fewer resources allocated for economic recovery.

2. The accounting and accounting law relationship with the local economy

The sources of data from the accounting of firms for the local economy are: the financial statements of companies with the activity centered at the head office and the accounting reports on secondary offices with relevant value. Because the most common types of secondary offices are workstations, the attention of the local economy is on the information on the workstations with significant activity in a given locality, a county, a development region. It is useful for the local economy for data to be processed either directly from the

accounting firms that operate effectively in a certain area (city, county or development region), or based on a representative sample.

Local public policies will take into account the work interests of companies with headquarters and the core activity in the area within range, but also the activity of secondary offices located in other areas.

The local economy can benefit from the following mandatory data according to the accounting law and the related legislation for the secondary offices (Table 1).

Table 1

Information available for local economy

Nr. crt.	Accounting and commercial law	Information available	Use for local economy
0	1	2	3
1	The existence of a secondary office must be registered with the Trade Registry and Financial Administration	The existence of secondary office	The Trade Registry database supports processing for the usefulness of the local economy
2	The significance threshold of the secondary offices in terms of the number of employees	The informational system includes secondary offices and the number of employees	They do reports and discounts separate from the headquarters for income tax and social contributions
3	The segment reporting requirement is stipulated in international accounting law, including geographical segments	Turn over, profit and loss, assets, number of employees, total salaries, average salary on every segment	Development of local economy
4	Cost management requires that when a secondary office has a relevant position, cost calculation of that secondary office must be held	All kind of costs of the company computed for head office	Forecasting for development or closing

This data required under the accounting law and related legislation represents the main bases that allow us to have a set of information available to the local economy.

There are a number of limitations of the accounting information system of firms in terms of usefulness to the local economy:

- a) According to EU rules the VAT code belongs to the legal person; therefore, since starting with the accession date, no secondary office can be registered in any country for VAT purposes; reports for VAT had so a small relevance;
- b) The tax discount system – the vast majority will be settled at the head office; so it can not be computed the contribution of secondary offices to public budget;

- c) focusing the signing of the contracts at the head office and the limited commercial competence of the secondary offices.

3. The accounting and accounting law relationship with macroeconomics

A lasting way out of the crisis and the avoidance of a new recession cycle involves, first of all, focusing efforts towards efficiency and waste elimination. Such an approach requires above all a system of indicators that can be tested. Firms accounting can do more than just test or validate the information available for public policies in national statistics. The capitalization of companies available data under their strict interpretation in terms of international accounting law allows, in many cases, the correction and completion of some macro-economic indicators. The most intense signals were regarding the imperfections of the Gross Domestic Product in terms of money supply expansion (Huerta de Soto, 2010, p. 430).

There are approaches that shape the relationship between enterprises and macroeconomics as a part (element) – whole (system) relationship; from this point of view, macroeconomics could be regarded as the sum of activities at the enterprise level. The image of processes of the national economy could be achieved by adding data from companies' accounting. The accounting and fiscal management of secondary offices leads to changes of the real economy and monetary flows in the territory. Accounting information is already collected and bookkept in accordance with the rules of international accounting law. The public policy at group level in relation to national affiliates and to consolidation operations (accounting and fiscal) needs to answer questions like:

- who benefits from the activity of an entity in particular in the case of foreign direct investments
- who should support an entity in difficulty during an economic crisis like the one initiated in 2008.

Interference between accounting and accounting law with the macroeconomics is achieved on Table 2.

Table 2

Interference between accounting and accounting law with the macroeconomics

Nr. crt.	Level of interference between accounting and accounting law with the macroeconomics	Informations available from accounting
0	1	2
1	Reporting public statistics and for the decision-making at macroeconomics level	The use of complex data processing systems to retrieve from firms' accounting information system the necessary data for reporting public statistics and for the decision-making at macroeconomics level

2	Public policies regarding environment matters in the information system	The use of information from accounting to transpose the requirements of public policies regarding environmental matters in the information system
3	Calculate the cost of labor	The use of accounting data to calculate the cost of labor, an important parameter of the macroeconomics policies any fiscal decision on macroeconomic level is better if is after computation on fiscal costs
4	Calculate cost of living	Taking the necessary data at firm level in order to calculate the cost of living
5	e-government	the administration and management of transactions tailored to the e-government project
6	Macroeconomic cycles	The evolution and trends of investments of the companies are depending of macroeconomic cycles

The correlation between the accounting information system and the information needs for macroeconomics decision making is materialized among others by:

- the use of complex data processing systems to retrieve from firms' accounting information system the necessary data for reporting public statistics and for the decision-making at macroeconomics level;
- the use of information from accounting to transpose the requirements of public policies regarding environmental matters in the information system;
- the use of accounting data to calculate the cost of labor, an important parameter of the macroeconomics policies;
- taking the necessary data at firm level in order to calculate the cost of living;
- verification using information accounting of the manner of compliance regarding sustainable development policies and industry structures;
- the administration and management of transactions tailored to the e-government project.

4. Establishing public policies for certain categories of enterprises based on information provided by accounting and accounting law

With the help of accounting law instruments we can concretely identify the size of local, regional and international dimension of the firms' activity. Usually, according to data from the firms' accounting, who primarily benefits from the activity of multi-national companies is the host country and subsidiary the firm's country of origin.

Indicators for the impact of branches on host are presented in Table 3.

Table 3

The impact of branches on host

Nr. crt.	Indicator from accounting of the company	Impact on host economy
0	1	2
1	Profit	If exist tax on profit increase incomes of the budget
2	Number of employees	Fight against unemployment
3	The payroll	Budget incomes

During the current crisis the following question was put: Who should support an entity in need? The options for responding to this question are: the state where the company operates or the state from where the company comes from. According to economic criteria, support should be given in the proportion the two countries benefit under the condition that the support should be used for the economic activity, not for redistribution within the group. The accounting law has the following tools to answer these questions:

- a) the account indicators of benefits in the host country or in the country of origin;
- b) the calculation of the redistributed value within groups parceled out on source groups and recipients.

In the context of the present financial crisis, the CEE countries exposure to the internalization of the financial flows becomes a key macroeconomic volatility driver, especially from the perspective of dependence of the foreign financing lines (Morar et al., 2011). From this point of view only the information from the balance sheet of the companies are relevant for public policies.

5. The accounting and accounting law relationship with the macroeconomics foresight and forecast

The accounting and accounting law relationship with the macroeconomics foresight and the forecast is based on the following aspects:

- the economic conjuncture;
- the economic cycle;
- the analysis of accounting data based on the inflation factor;
- handling data of the firms' accounting that is used for forecasts or examinations regarding the economic conjuncture.

Interpretation of the accounting data includes considering and adjusting the economic situation in the national economy.

It tries to make the data comparable by referring to the price system, market and resources development.

In the economic conjuncture criteria, calculations are being made at the sectoral level and also relying on the structure of the elements (price, sales, costs, etc.) for adjusting the data in the field of analysis.

Data from the firms' accounting can provide information on the correlation's intensity between macroeconomics policies on the parameters of the reference interest rate or the official exchange rate of the national currency and the turnover's evolution speed or other indicators relevant to the business cycle. Data can be collected from a representative sample of economic agents from different sectors of activity regarding the cost of financing and the cost of exchange differences. The monetary interest rate policy of the central bank and the developments of the exchange rate of the national currency is then put in relation with the indicators of business cycle from the firms' accounting. If there is a strong correlation, it means that orthodox macroeconomics policies are validated in the national economic space for those activities. On the contrary, a mild or negative correlation between the two factors means that the economic environment does not respond to orthodox macroeconomics policies, and other instruments of action are to be identified.

Financial and accounting data analysis based on the inflation factor is a direct application of the correlation between the macroeconomics conjuncture and the accounting law. Note that a particular standard is applicable for firms' accounting in inflationary economic environments. This can radically alter the results of the analysis to firms that work with small business margins.

There are situations where data from firms' accounting is processed to estimate the future economic conjuncture climate. For this type of economic research, special statistic surveys are being used. In this case the accounting data will be adapted and adjusted to the specific branch from which the company has been the subject of investigation.

6. The accounting and accounting law relationship with the labor economy

The accounting and accounting law relationship with the labor economy include:

- determining the content of the reports to the union;
- the correlation between the standards system and the economic performance indicators;
- cost accounting policies for work security;
- the correlations between the work indicators and the payroll indicators;
- the elasticity of wages comparing to the level of activity (turnover, production value, etc.) in terms of expansion/restructuring/recession;

- the identification of the correlation parameters of the wage level at the firms subject to processes of acquisition, merger, asset sale (“sale per piece”);
- the correlations between corporate accounting law and statutory internal documents regarding work relations;
- the correlation between the firm's accounting policy and the occupational safety.

One of the complexities of the economy in which accounting and accounting law can make a significant contribution is the correlation of the employment and wage indicators. The contribution of accounting takes into consideration the following:

- the calculation of the elasticity of wages is required for changing the workload in different phases of the economic activity; the wages are rigid under European legislation to the reduction of the workload and have a faster growth trend during the ascension.
- evaluating the impact of the fiscal system in the firms accounting on the elasticity of wages to the tax system workload changes in different phases of the economic activity. Note that in the global tax system the increase in workload, using the same number of staff determines the increases of the wage ration in the turnover. Instead, in the flat tax system wages remain directly proportional to the workload, on the occasional changes, using the same number of personnel or a different number. For this reason it is risky for the employer in the global system to negotiate the net salary because he doesn't know what other activities the employee has, activities which determines the alteration of the owed income tax. Instead, in the flat tax system the income tax is the final tax.
- the accounting law helps clarify the faster wage growth than the volume of activity (data centralized at national level in the ascension and restructuring periods); during the ascension period with restructuring (2005 – 2008 for Romania) wages have grown faster than the total volume of activity (data supplied at national level) because of the supraunitary coefficients imposed by:
 - inflation;
 - transfer from material consumption to wages (the added value increases);
 - additional pressure on the labor market;
 - the activities complexity increases;
 - the explanation of wage rigidity.

Wages are inflexible to the reduction of activity under conditions of crisis and recession due to the following factors:

- the minimum wage set by the state through government decision;
- the form of payroll;
- the mechanisms for collective wage bargaining;
- significant restructuring costs of firms.

Accounting can provide information to calculate an optimal threshold for the loss of personnel wages under which it is feasible to initiate restructuring proceedings.

It is very important the impact on the public economic policies in case of change in company ownership.

The financial flows and the gross salary of the employees before and after the merger or separations are mainly relevant for public policies. The cash flow statements and the reports from payroll system have enough information both for accounting and government decision in this case.

If the case of an entity liquidated by assets also called sale of assets, the object of activity is gone. Usually in such cases most of the staff lose their jobs. For the local economy is very important to know the total gross salary after the change of the shareholders compared to the previous level. The net salary of the staff, a component of gross wage, is a maintenance source of the commercial activities and local services. In turn, the economic activities of any kind allow a flow of cash to the local budget. The analysis in terms of local interest for any project that involves changing employers will have to take account of the developments of the total gross wages. In several categories of projects in Romania that would interfere with the business ownership in enterprises with a decisive share for the local economy the debate has not focused on this criteria (total gross wages), which moved the debate to difficult to measure criteria and whose impact on the local economy had a questionable intensity.

Conclusions

In the post-crisis period a significant improvement in public policies is required so that they can use the information supplied by the accounting and the accounting law to greater extent. The idea that information is power is accepted. For this reason you may need to take greater account of the relationship of the accounting information and accounting law with the local economy, macroeconomics. We proposed that in every kind of project of economic and public interest the total gross wage or incomes dynamics criterion to be preserved.

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Impact and Limitations Deriving from Basel II within the Context of the Current Financial Crisis

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Abstract. *The Banking sector risk management framework, geared towards maintaining a solid capital adequacy level, has witnessed a permanent evolution, determined by the global economic and financial reality.*

Basel II has brought an improvement of the risk management framework by adding minimum capital levels corresponding to market and operational risk and by the introduction of internal rating models. However the current crisis has brought forward some adverse effects as well as limitations.

This paper analyses the evolution of prudential rules and regulations introduced by Basel II and their impact on the banking system together with outlining certain limitations.

Keywords: Basel II; Basel II limitations; financial crisis; prudential rules.

JEL Codes: G01, G21.

REL Codes: 11B, 11C.

1. Introduction

The banking system plays a major role in the global economy, as the main provider of liquidity and payments platform. According to Benjamin Cohen, the banks are “a lubricant to grease the wheels of commerce”. In order to fulfill this function, the banking system has to have access to necessary resources in order to properly respond to any economic imbalance. In this respect, the banking rules and regulations together with maintaining safety limits have been a top priority for specialists, authorities and market supervisors.

The current financial crisis has clearly shown serious failings in the supervision and regulation of the international financial system. Its causes have been a favorite topic for specialists and theorists and a multitude of factors have been identified, on both micro and macro levels.

The amplitude of the crisis was generated also by a relaxation of the global financial market safety nets: decrease of provisions (especially during 2001-2006), relaxed capital margin rules (actual level - minimum level as per regulation) due to large inflows of foreign funds, unwillingness of bank shareholders to increase the capital and introduction of hybrid (debt/equity) products categorised as equity, relaxed capital adequacy rules through preference towards low capital consuming products (i.e. trading, sovereign etc.), the emergence of “shadow banks” (funds, financial services providers) which raise funds from the market but are not guaranteed by authorities, the lack of early intervention of the financial authorities (Cannata et al., 2011)

Considering this relaxation of the safety nets, the banking system has lacked the necessary resources to deal with the subprime crisis generated losses. During H1 2008, the top 10 global financial institutions recorded a cumulated loss of USD 490 billion (Cannata et al., 2011). And the bankruptcy of Lehman Brothers in September 2008 amplified the effects of the crisis and generated massive withdrawals on the monetary market together with the collapse of commercial debts and international interbank market.

On top of this, some specialists consider that the limited introduction of Basel II (coming into force only at the beginning of the crisis) and lack of correlation between prudential and accounting regulations have also fueled the crisis (Ranjit, 2009).

Within this context, this paper analyses the evolution of the main Basel II requirements and provisions and the impact of the financial crisis on the prudential rules and regulations.

2. Basel accords timeline

The Basel I accord has been promoted by the Basel Committee in 1998 and subsequently implemented by the banks starting with 1992. The starting point was represented by the document published in December 1987 by the Basel Committee, on unifying the measurement methods for capital adequacy and establishment of capital adequacy standards for international banks. This document was issued due to increasing concern with respect to deterioration of capital ratios due to increased credit risk.

Basel I considered only the credit risk in the measurement of capital adequacy and covered at first issues related to capital measurement (1st and 2nd tier), risk weighting (associated to various asset classes – 0%, 20%, 50% and 100%) and capital adequacy rules (8% ratio of capital to risk weighted assets).

By studying the timeline of Basel 1 provisions, I consider as important certain changes (amendments) which in my opinion brought value to the original rules: provisioning/reserves for credit losses (1991), assessment within the capital adequacy framework of the credit risk generated by off-balance items (July 1994) together with its improved rules and regulations (April 1995), introduction of market risk within the capital adequacy measurement methods (January 1996). With respect to market risk, two alternative methods for capital adequacy measurement were introduced: standardised approach and internal VAR models – rules subsequently improved in September 1997.

Although extremely complex and revolutionary at that time, Basel I rapidly failed to address the rapid developments of the financial markets so a new capital adequacy framework was needed. So, in June 1999 the Basel Committee issued a proposal regarding changes to capital measurement and capital adequacy rules for international banks.

Basel II was published in June 2004, following a large scale consultation process with representatives of the banking sector, authorities and businesses. In 2005 the capital standards were revised and improved by adding new rules on market risk and repeat losses; in June 2006 the full version of the accord has been published.

Basel II is built on three pillars: minimum capital requirements (flexible but advanced rules on measuring the minimum capital based on credit risk, market risk and operational risk), prudential supervision process (qualitative approach) and market discipline (detailed reporting requirements on shareholders, exposures, capital adequacy), with the final aim of increasing the safety and stability of the international financial market.

To evaluate each risk category, Basel II is proposing several options (BIS, Basel II, 2006):

- For credit risk: standardised approach, internal rating approach (IRB) and advanced internal rating approach (A-IRB);
- For market risk: Standardised approach and internal Value at Risk (VAR) models approach;
- For operational risk: basic indicator approach, standardised approach and advanced measurement approach (internal forecasting).

I. Credit risk approaches

Standardised approach – various risk weights (as indicated by international rating agencies) are allocated to various types of exposures to banks, companies and sovereigns (governments, central banks, local or central public sector entities).

IRB approach – the banks are using their own predictions on probability of default (PD) associated with each client. The additional risk factors – Loss given default (LGD) and Exposure at Default (EAD) are set by the supervision authorities. The banks have to adhere completely at certain standards set by such authorities.

A-IRB approach – risks are estimated internally; this approach is applied only by institutions wishing to adhere to the most rigorous market authorities standards. Credit risk decrease methods are employed i.e. collateral quality, credit derivatives etc.

The standardised approach is widely used by banks given its compatibility with Basel I rules and its fast implementation; nevertheless more and more banks are switching to IRB or A-IRB (targeting a more accurate risk assessment).

II. Market risk approaches

The market risk measuring methods set by the Basel 1996 amendment are still valid – the standardised approach (based on supervision authority standards) and internal VAR models approach; Basel II has brought only minor changes.

III. Operational risk approaches

Basic indicator approach – a basic indicator (i.e. revenues) is chosen and a percentage indicated by the supervision authority is applied;

Standardised approach – the bank's activity is divided into several business segments; for each segment a basic indicator is chosen and a percentage indicated by the supervision authority is applied;

Advanced measurement approaches – by using internal risk prediction models, to be validated by the supervision authority.

With respect to the operational risk measurement I consider the main challenge to the banks to be represented by developing a complete and accurate database dealing with operational risk losses for each business segment.

Second pillar – prudential supervision process

According to Basel II, the bank's management is directly responsible to manage the risks and maintain capital to such levels in accordance with the institution's risk profile; at the same time the authorities are responsible for creating a proper regulation environment and supervise its applicability (proper capital requirement measurements and associated actions to correct potential imbalances).

In this respect Basel II outlines several principles:

- The banks have to have internal processes and procedures for capital measurement, according to their risk profiles, together with strategies for dealing with any contingencies;
- The supervision authorities are required to evaluate such internal procedures and strategies together with each bank's capacity for monitoring and compliance;
- Also the supervision authorities are expected to ensure that capital requirements levels are maintained across the banking sector above the minimum acceptable figures. In this respect, levels above minimum may be required by authorities overall or for certain individual categories;
- Supervision authorities have to be capable of early intervention if any capital requirement negative developments are spotted, in order to demand swift action from the affected institution(s).

Third pillar – market discipline

In order to ensure an optimum level of market discipline, Basel II introduced certain periodic reporting requirements (half year or quarterly) for critical information on bank's activity, in order to provide reliable info to all current or potential bank counterparties on risks and financial performance.

Basel II status as at end of March 2012

Basel II can be considered as fully implemented only if all its three pillars are applied. A minimum implementation can be considered the application of first pillar only.

From a purely legal point of view, Basel II is a set of recommendations provided to international banks, avoidance of implementation cannot be officially sanctioned. However, as a parallel initiative, the European Commission revised its own requirements pertaining bank capital in order to create a common set of rules across the European Economic Community.

The new requirements have been developed by both institutions (Basel Committee and EC) through consultations with representatives of the supervision authorities, banking system and corporates in order to meet a spectrum of requirements as broad as possible, resulting in an European Directive implemented across EU countries.

According to the Bank for International Settlements, as at 31 March 2012, Basel II is functional in EU, Australia, Brazil, Canada, Hong Kong, India, Japan, Korea, Mexico, Saudi Arabia, Singapore, South Africa and Switzerland. A partial application is currently in Turkey, China and Indonesia and Argentina is considering the switch from Basel I to Basel II when it comes to credit risk.

In Russia, the second pillar will be introduced not earlier than 2014; the basic approaches for credit, market and operational risks are already introduced. In US all international banks are required to adopt advanced approaches for credit and operational risks – these banks are currently performing dual reporting: Basel I and Basel II while the other banks are reporting only based on Basel I requirements.

4. Basel II impact on capital requirements

Based on various European and international studies, I am going to analyse the Basel II adoption impact on credit institutions.

I am starting by presenting in Table 1 the impact on minimum capital requirements according to the results of impact study 5 (BIS, QIS5, 2006) done by the Basel Committee on 383 G10⁽¹⁾, and CEBS⁽²⁾ (Committee of European Banking Supervisors) banks non-G10⁽³⁾.

Table 1

Capital requirement variations following the switch from Basel I to Basel

	Standardised	IRB	A-IRB	Most probable approach
G10 group 1	1.7	-1.3	-7.1	-6.8
G10 group 2	-1.3	-12.3	-26.7	-11.3
CEBS group 1	-0.9	-3.2	-8.3	-7.7
CEBS group 2	-3.0	-16.6	-26.6	-15.4
Non G10 group 1	1.8	-16.2	-29.0	-20.7
Non G10 group 2	38.2	11.4	-1.0	19.5

Source: BIS – QIS5.

An analysis of the data shows significant deviations on capital requirements depending on the chosen approach (IRB or Standardised); the banks using the standardised approach being at disadvantage: for G10 group 1 banks an average increase of 1.7% for Standardised approach compared with a 1.3% decrease for IRB and 7.1% for A-IRB. The G10 Group 2 banks record a steep decrease for A-IRB; however, given the most probable chosen method the forecasted decrease would be of 11.3%.

The same trend of capital requirements decrease is valid for CEBS (group 1 and 2) and non-G10 group 1 banks, especially considering IRB approach. At the same time, the results pertaining non-G10 group 2 banks are widely spaced, mostly due to the presence of many niche banks and differences in national rules and regulations.

Appendixes 1 and 2 outline the effects on capital requirements based on types of exposures, segmented on G10, CEBS and non-G10 banks.

It is obvious that in the case of standardised approach the retail portfolio (especially mortgage loans) triggers the greatest reduction of capital requirements for all six groups of analysed banks, generating impacts between -3.2% (non G10 group 2) and -11% (CEBS group 2) depending on the weight of retail in total business.

A significant reduction appears in the SME portfolios (approximately -20%), but the overall impact is reduced given the small share of such business in total bank exposures.

The capital requirements are however higher for sovereign and interbank exposures, but, like SMEs, the overall impact is reduced (small share in total business). It is clear that emerging market exposures are going to generate higher capital requirements given both sovereign and interbank considerable flows towards such areas.

The operational risk determines an increase of capital requirements across all segments, its impact ranges between +3.5% for non-G10 group 1 and +13%

non-G10 group 2 (extremely diversified sample), between +5.6% and 8.3% for G10 banks and between +5.5% and 9% for CEBS banks.

If we are to look at the most probable approach to be implemented results, for all six groups there is a reduction of capital requirements ranging between -4.5% (G10 group1) and -20.7% (non-G10 group1).

As I mentioned, the decrease of capital requirements is mainly driven by the retail portfolio (50% decrease for G10 and CEBS banks, 75% decrease for non-G10 group1). Its impact on total portfolio ranges between -8% G10 group 1 and -20% CEBS, based on its weight in total business (G10 group 1 are banks more focused on corporate and international business while group 2 is more retail focused). A particular situation appears for non-G10 group2 banks, for which the retail portfolio determines an increase of capital requirements of 6.5%, due to higher PD and NPL levels.

Unlike standardised approach, by employing IRB approach the corporate portfolios registers a decrease of capital requirements of approximately 20–25% with an impact on overall portfolio of approximately -3 – -5%. Also, the equity investments portfolio does not have a major impact by using standardised approach; nevertheless if using IRB this portfolio generates additional capital requirements between 80% and 130% (impact on total portfolio + 3%).

The operational risk determines an increase of capital requirements across all bank categories with 6%–7%.

5. Overall impact and limitations of Basel II

The analysed studies show the fact that the Basel II impact on capital requirements is being influenced by both the utilised approach and bank's risk profile. At a quick glance it becomes clear that the banks utilising standardised approach are at disadvantage compared to the ones employing IRB or A-IRB approaches.

Considering the risk profile, the local retail banks, especially those registering large mortgage exposures, can benefit from important reductions of capital requirements while at the opposite the investment and emerging markets banks are going to be subject to additional capital requirements.

On long term, Basel II should trigger a reduction of the cost for the banks (reduced capital requirements for several lines of business); however most probably we will witness negative impacts for a while due to implementation costs and/or the efforts of smaller banks to raise additional capital.

In my opinion, Basel II has definitely added value to the prudential rules and regulations, answering in many instances to the need to promote increased safety of the financial sector. The new requirements improved the prudential

framework by adding minimum capital requirements for market and operational risks, improved assessment of risk sensitivity (more classes of assets and types of exposures) and introduction of internal models for credit risk.

Nevertheless real life implementation proved several negative impacts and limitations of Basel II, especially in the light of the current financial crisis.

One of the main negative impacts is represented by significant reductions of capital requirements for banks utilising internal models not correlated with their ability to withstand systemic crises – an overestimation of their capacity to properly assess risks by using internal models. The “model risk”, generated by the lack of macro variables and improper internal mechanisms for risk measurement, triggered an imbalance between exposures and capital (unjustly amplifying the leverage and volatility of capital requirements) (Georgescu, 2012).

Too much emphasis on the external ratings is another negative side of Basel II: rating agencies have been too optimistic in setting the ratings (basically no rules in force in this respect) and Europe (especially Eastern Europe) has benefited much later (1990s) from the presence of external ratings and rating agencies compared to US.

Basel II provisions also generated an underestimation of capital requirements in relation to the banks’ trading books by employing untested and unrealistic VAR models (Atik, 2009).

Securitisation transactions have also contributed to the contagion effect and triggered systemic risks, which are not fully addressed by the current rules.

One other limitation worth mentioning is represented by the fact that liquidity risk is improperly addressed by the Basel II framework on both financing side and individual asset liquidity (Georgescu, 2012).

One last remark refers to the fact that Basel II generated competitive advantage for the large banks owning infrastructure and resources to implement its requirements and also for non-banking financial institutions not subject to Basel II requirements.

6. Conclusions

The framework of prudential rules and regulations has been witnessing a permanent change in order to adapt. Triggered by concerns regarding the capital of the large international banks, Basel I became soon unfit for capturing the full spectrum of risks associated with banking activity - it utilised a limited number credit risk weights and did not address means and complex supervision procedures for credit institutions.

Basel II brought a clear improvement of the prudential framework by offering banks a larger range of alternatives to determine capital requirements associated with credit risk. The three proposed approaches enjoy different degrees of complexity, allowing banks to choose the most suitable one, according to their necessity, risk profile or supervision authorities strategy. Another positive issue is represented by the introduction of capital requirements associated with market and operational risks.

Basel II also sets up clear and strong connections between calculation rules for capital, adequacy standards, market supervision and market discipline. The rules are more risk sensitive than those outlined in Basel I, however not sufficiently adequate in order to strengthen the banking system enough to be able to respond to the challenges of the financial crisis. The current financial crisis has put under the spotlight some negative aspects of the Accord: lack of macro variables, procyclicality, liquidity risk improperly addressed, trading book related issues. Excessive reliance on external ratings and incorrect internal rating models also allowed for artificial reduction of capital requirements and decrease of banks' capacity to withstand systemic crises.

Nevertheless, Basel II represented an important step forward in the prudential framework through the creation of clear standards for risk sensitive capital regulations.

Given all the above, an improvement of the rules and regulations framework has become a must; the next step – Basel III is targeting new capital and liquidity regulations in order to significantly improve financial stability at the same time maintaining the basic principle of Basel II – direct connection between risk and capital. Of course, it remains to be seen if, as intended, these new rules will considerably strengthen the banking system's resilience when confronted with serious crises.

Notes

⁽¹⁾ 56 banks in G10 group 1, 146 banks in G10 group 2. G10 – the 13 countries member of Basel Committee – Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, Netherlands, Spain, Sweden, Switzerland, UK and USA.

⁽²⁾ CEBS Group – EU and EC member countries: G10 and Bulgaria, Cyprus, Czech Republic, Finland, Greece, Hungary, Ireland, Malta, Norway, Poland and Portugal.

⁽³⁾ Non-G10 countries – Australia, Bahrain, Brazil, Chile, India, Indonesia, Peru, Singapore.

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Appendix 1

Overall results – standard approach relative to Basel II

Portfolio	G10						CEBS						Non-G10					
	Group 1			Group 2			Group 1			Group 2			Group 1			Group 2		
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
Corporate	27	3.2	0.9	16	-6.5	-1.0	17	-1.9	-0.3	10	-6.1	-0.6	20	2.1	0.4	35	-0.5	-0.2
Banks	4.9	30	1.5	5.1	4.3	0.2	6.0	29	1.8	6.0	-11	-0.7	1.9	64	1.2	5.1	45	2.3
Sovereign	0.4	55	0.2	0.5	-14	-0.1	0.4	98	0.4	0.2	27	0.1	0.1	81	0.1	0.9	1643	14
SME corporate	8.6	-2.5	-0.2	16	-0.5	-0.1	8.3	-5.1	-0.4	13	1.5	0.2	9.9	0.5	0	6.5	-1.2	-0.1
Special credit	4.6	-5.5	-0.3	1.5	7.2	0.1	5.4	-6.4	-0.4	1.7	-0.6	0.0	1.7	-2.5	0	0.2	79	0.1
Retail:	26	-27	-7.1	36	-25	-9	33	-27	-9	41	-25	-11	17	-24	-4.1	21	-15	-3.2
-Mortgage	22	-28	-6.3	22	-28	-6.2	28	-28	-7.8	24	-28	-7.2	14	-29	-4.1	3.6	-3.3	-0.1
-Revolving	0.6	-20	-0.1	1.2	-22	-0.3	0.7	-23	-0.2	1.4	-22	-0.3	1.3	-3.1	0	2.3	-25	-0.6
SME retail	1.8	-23	-0.4	5.8	-20	-1.2	2.7	-22	-0.9	8.1	-21	-1.7	0	73	0	3.7	-22	-0.8
Capital	3.2	53	0.2	3.2	-0.9	0.0	1.2	18	0.2	1.8	1.8	0	0.1	-1.5	0	2.2	-1.1	0
Purch. receivables	0.3	-6.2	0	0.3	-3.4	0	0.1	-19	-0.1	0.2	-0.7	0	0	0	0	0.6	9.4	0.1
Securitisation	3.0	7.4	0.2	17	31	0.5	2.6	13	0.4	1.2	5.0	0.1	0.3	102	0.3	0.8	-18	-0.1
Counterparty risk.	1.2	35	0.4	0.1	42	0.1	1.6	34	0.9	0.1	46	0.1	1.3	67	0.9	0	1739	0.6
Specific risk	1.3	5.4	0.1	0.3	1.7	0	1.3	6.5	0.1	0.4	2.6	0	0.9	12	0.1	1.6	306	5.0
Market risk	1.6	0.6	0	1.2	0	0	2.1	0.9	0	1.7	0	0	1.8	0	0	633	22	1.4
Related entities	4.7	16	0.8	1.7	41	0.7	5.7	20	2.0	2.3	37	0.9	7.5	0	0	5.2	124	6.4
Other deductions	3.5	0	0	2.3	0.6	0	5.0	-0.5	0	3.2	-1.2	0	32	0	0	2.6	-25	-0.6
Others	3.9	-1.1	0	4.21	1.3	0.1	4.2	-3.2	-0.2	5.4	1.2	0.1	2.7	-19	-0.5	0	0	0
Operational risk	-	-	5.6	-	-	8.3	-	-	5.5	-	-	9.0	-	-	3.5	-	-	13
Total	100	-	1.7	100	-	-1.3	100	-	-0.9	100	-	-3.0	100	-	1.8	100	-	38

1- size;

2- variation,

3- contribution.

Source: Impact Study 5 (QIS5).

Appendix 2

Overall results most likely IRB approach relative to Basel II

Portfolio	G10						CEBS						Non-G10					
	Group 1			Group 2			Group 1			Group 2			Group 1			Group 2		
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
Corporate	27	-18	-5	17	-27	-5	23	-17	-4.0	13	-29	-3.6	16	-27	-4.3	23	-18	-4
Banks	3.8	10	0.4	4	2.4	0.1	4.3	-4.5	-0.2	4.3	-0.1	0	2	9.5	0.2	4.9	-19	-0.9
Sovereign	0.5	239	1.3	0.4	139	0.6	0.5	179	0.9	0.1	391	0.5	0.2	40	0.1	0.2	40	0.1
SME corporate	6.9	-19	-1.3	15	-14	-2.2	7.2	-18	-1.3	13	-19	-2.4	10	-33	-3.3	3.2	78	2.5
Special credit	3.4	-11	-0.4	2.4	7.8	0.2	4.2	-17	-0.7	2.7	5.8	0.2	3	-13	-0.4	0.3	88	0.3
Retail:	17	-46	-8	34	-51	-17	20	-44	-8.9	37	-54	-20	20	-75	-15	21	32	6.5
-Mortgage	12	-64	-7.6	21	-58	-12	14	-65	-8.9	23	-62	-14	17	-83	-14	0.4	183	0.7
-Revolving	1.5	23	0.3	1.1	-19	-0.2	1.6	49	0.8	1.3	-28	-0.4	1.6	37	-0.6	5	48	2.3
SME retail	2.9	-49	-1.4	7.2	-46	-3.3	4.1	-50	-2	8.8	-45	-4	1.6	-72	-1.1	0.3	26	0.1
Capital	3.1	85	2.6	2.8	130	3.6	1.3	82	1.1	1.7	127	2.2	0.2	66	0.1	0.1	63	0.1
Purch. receivables	0.1	17	0	0.2	18	0	0.1	-40	0	0.1	-14	0	0	0	0	1.6	150	2.4
Securitisation	2.8	0.5	0	1.7	-24	0.4	2	8.6	0.2	1.3	-27	0.4	1.3	-35	-0.5	1.9	-60	-1.2
Counterparty risk.	1.9	15	0.4	0.3	26	0.1	2.3	9	0.2	0.3	14	0	1.2	8.8	0.1	2	-50	-1
Specific risk	1.4	4.1	0.1	0.9	-0.6	0	1.5	5.1	0.1	1.1	-1	0	0.9	11	0.1	1.9	-26	-0.5
Market risk	2.5	-0.7	0	1.6	0.4	0	2.9	-2.1	-0.1	1.9	0.4	0	1.8	0.1	0	12	-64	-7.6
Related entities	6.8	8.1	0.6	3	44	1.3	6.9	13	0.9	3.6	43	1.6	6.7	-0.3	0	3	65	1.9
Other deductions	12	-0.1	0	2.2	3	0.1	13	0	0	2.9	0	0	29	-0.8	-0.2	3	0	0
Others	2.8	9.3	0.3	4.8	3.9	0.2	3.1	12	0.4	6	3.8	0.2	3	-19	-0.7	0	0	0
Operational risk			6.1			7.5			5.8			7.7			4.5			6.8
Total	100		-4.5	100		-14.	100		-7.5	100		-18	100		-21	100		-5.4

1 - size;

2- variation,

3- contribution.

Source: Impact Study 5 (QIS5).

Models of the Economic Growth and their Relevance

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Abstract. *Until few years ago, the economic growth was something perfect normal, part of an era marked by the transformation speed. Normality itself has been transformed and we currently are influenced by other rules, unknown yet, which should answer the question: “How do we return to the economic growth?” The economic growth and the models aiming to solve this problem concern the economic history even since its beginnings. In this paper we would like to find out what is the relevance that the well-known macroeconomic models still have and which might be their applicability level in a framework created by a black swan event type.*

Keywords: economic growth; Solow-Swan model; economic crisis.

JEL Codes: E10, E13, E22, F43.

REL Codes: 8E, 8L.

1. Introduction

The economic growth is a notion which grids both the governments and the normal people at the moment of speech. Why? Because we are still kept inside the waves of a big storm which is far from being stopped; in fact we are facing the threatening of a second wave, perhaps more dangerous than the first one. What does this *economic growth* mean? According to mainstream and to most of the economics textbooks, this has been defined as an increase of the capacity of one economy to produce goods and services, using a comparison between two defined periods. The economic growth might be measured in nominal terms, which include inflation or, in real terms, adjusted with inflation. Often, the economic growth is associated with the innovation part and with the technological changes. One good example in this direction is represented by the emergence of the Internet and the changes underlying the production process which have been brought by this new technology. We shouldn't understand through the economic growth just the increase capacity of production of one economy, but also an improvement of the life quality of those people which are part of that economy⁽¹⁾. The economic growth can be measured through the percentage changes of various indicators GDP, GNP and GDP per capita.

Professor Raul Romer (2007), from Stanford University, in one of his writings in *The Concise Encyclopaedia of Economics*, explains the vision of one banker preoccupied by the growth part, compared with what means the part of economic growth for a government. If we have a chessboard (in total 64 squares) and put a cent on the first square, two cents on the second square, four cents on the third one, eight – on the fourth square, we will end up to have on the last square about 92 million dollars. If we use in this multiplying process just the white squares, we'll have about 21.5 million dollars. Of course, the banker will decide to use all the squares, being preoccupied just by the profit, irrespective if we talk about dollars, pounds or lei. When talking about a government, the situation changes, because the State should take into consideration the growth rate (highlighted by the two above different situations – either using all the squares, or using half of them). Thus, the concern for choosing the optimal variant, between doubling the income from one generation to the other, or doubling the income every two generation – decrease all other concerns regarding the economic policies.

In reality, the things are not quite like this. If between 1950 and 1975, for instance, India had a yearly GDP growth rate of 1.8%, we could see how long it will take to this country to double the GDP, using the rule of 72 (in finance, the rule of 72 is a method used to estimate the period of time the value of an investment doubles). By dividing 72 to 1.9 we find out that India could double its GDP in about 40 years. The same rule might be applied for China: to a

yearly GDP growth rate of 10%, China could double the income, by maintaining the same growth rate, in about seven years (Romer, 2007).

The economic growth models were interesting for the economists ever since the classical period (Adam Smith, David Ricardo). Keynesian models, as well as their direct descendants, the Neo-Keynesian models, claim that in order to have a stable economy it is necessary to use macroeconomic politics and the direct intervention of State for reaching the equilibrium and stimulating the economic growth. On the other side there are the models of the Neo-Classics, who are saying that the economy is self-stable and the equilibrium comes naturally.

All above-mentioned growths must be comprised in models, because the systematic structuring of reality into models represents a passion – sometime too burning passion – of the modern scientific phenomenon. In this paper we will focus on the validity and viability of these models during crisis times and we will try to define which their grade of applicability is, taking into consideration the mentioned conditions. Also, taking into consideration the fact that the research is in an incipient stage, the main model used here will be the neoclassical model of growth (Solow-Swan).

2. The Solow-Swan economic growth model

One of the most known models of economic growth is the neoclassical model or the Solow-Swan model of growth, as it is known in the specialised macroeconomic literature. This model is an extension of the growth model Harrod-Domar (1946); and the extension is represented by including in the model a new term: increase of productivity. In this new model, the new capital is more valuable than the old capital, because it appears as a result of the improvement of technology during the time.

Further, we will briefly present few of the main characteristics of this model, as well as the function on which this is built, but also changes of the models due to the variable compounds.

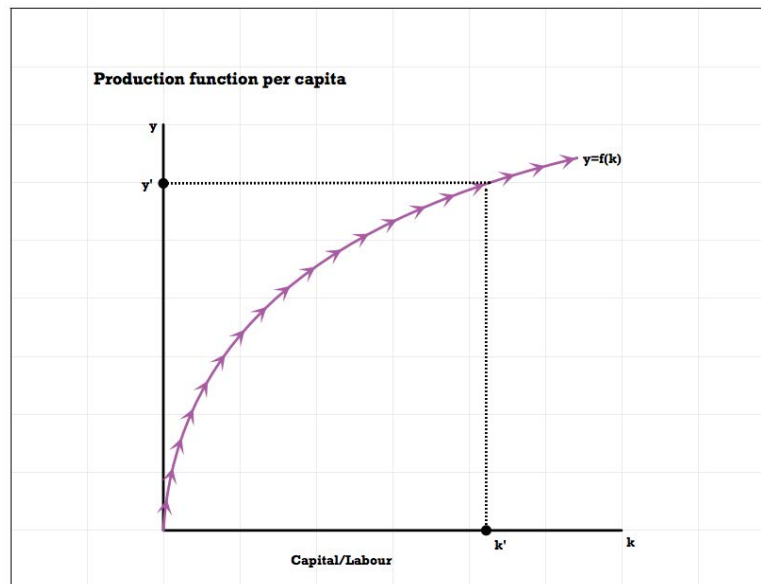
This model actually shows how the rate of economic growth, the population growth and the technological progress influence the economic growth during a certain period of time. The premises used in this model are:

- The economy is perfectly competitive;
- There are two production factors which are perfectly substitutable (work L and capital K – in the initial analysis does not appear the technical progress);
- The perfect mobility of the production factors;
- Complete employment in using the resources (Socol, 2009).

In this model, the production function is one of the type Cobb-Douglas, in the following format:

$$Y = A \times K^{\alpha} \times L^{\alpha-1}$$

The production function represented by the correlation between the output per inhabitant and the coefficient capital-work may be graphically represented as follows (Dornbusch et al., 2007):

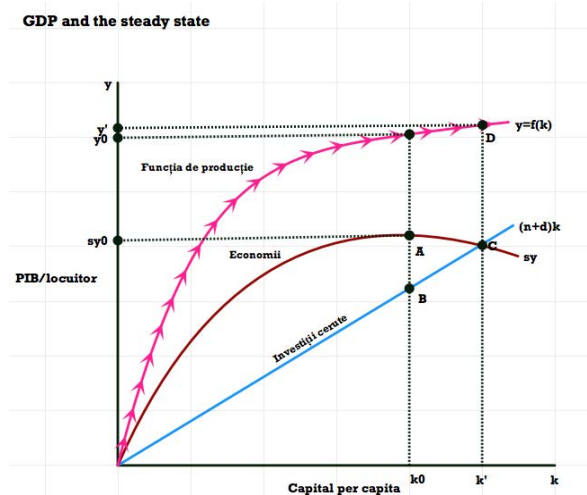


Source: redrawn graphic after the same name graphic from Macroeconomics – R. Dornbusch, Stanley Fischer și Richard Startz.

Figure 1. *Production function per capita*

The model takes into consideration a closed economy, with a single sector in which the homogeneous production has as destination either the consume or the investments, in order to create new capital units and the savings are equal to the investments. The capital will have a constant and positive depreciation rate (Socol, 2009).

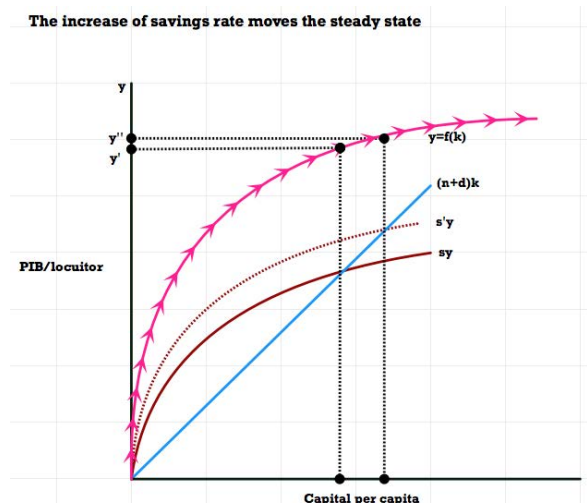
In the above graph we may notice that once the capital increases, the output increases, too. However, as we go on the capital axe, one may notice that this will produce lower results compared with the previous period, due to the decreasing product of the capital. This might be an explanation for the fact that an economy reaches a steady state, instead of continuing its growth for an unlimited period of time. What does it mean a steady state? An economy will naturally go towards a steady state, according to the neo-classical model. The investment necessary to maintain a constant level of the working capital will depend on the population growth rate, but also on the depreciation speed of the capital. Therefore, we have below the graphical representation of the steady state:



Source: redrawn graphic after the same name graphic from Macroeconomics – R. Dornbusch, Stanley Fischer și Richard Startz.

Figure 2. *The GDP and the steady state investment*

What will happen with the economy when the growth of the saving rate (sy) in the above graph will start increasing? According to the neo-classical theory, the saving rate will not affect the long-term rate of economic growth, but will long-term influence the level of the output/capita. This problem can be graphically expressed as follows:



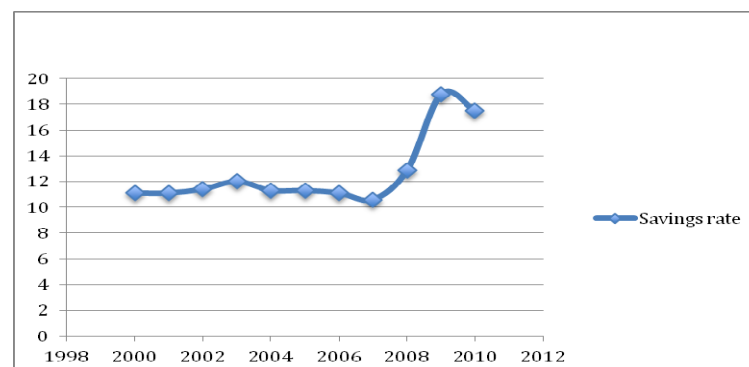
Source: redrawn graphic after the same name graphic from Macroeconomics – R. Dornbusch, Stanley Fischer și Richard Startz.

Figure 3. *Growth of savings rate moves the steady state*

3. Anomalies during crisis time

Further, we will use only this variation of the model Solow-Swan in order to reach the practical side of the matter discussed in this paper. One of the reasons is that, in our opinion, the saving rate represents one of the main indicators of an economy, but it reflects the level of the financial education of one nation (if the saving rate is high, of course the amount of incomes for consume is more reduced). Even if the model of growth discussed above has some limitations (the premises itself on which the model is based), we will try to find equivalents into the real economy, in order to test – however at a low grade of accuracy – the validity of this model during crisis time.

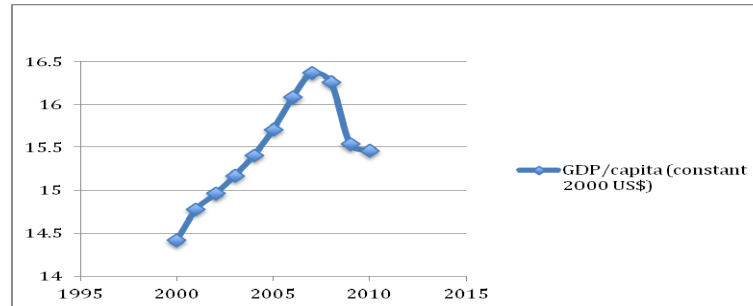
Considering the fact that this crisis began in the period 2007-2008, we cannot focus the analysis on a long period of time, as the neoclassical theory requests, however we will take into consideration the evolution of the Spanish economy during 2000 and 2010. The reason for which we have chosen this country is that at the moment the crisis began this was one of the countries powerfully hit by crisis, but also that the anomaly which appeared here can be better observed than in other countries. In the next two graphs we can notice the evolution of GDP per capita, calculated in USD 2000, and also the evolution of the savings rate.



Source: World Bank Quick Query.

Figure 4. *Savings rate for Spain*

In this graph we can see a relatively linear evolution of the trend between 2000 and 2007, the level of the savings rate being in the range of 10-12 percentages. Once the crisis appeared, it may be seen that the saving rate started to exceed the range into which it fluctuated during the previous years.



Source: World Bank Quick Query.

Figure 5. *GDP/capita evolution for Spain*

The GDP per capita had – as it was in most of the countries – an ascending trend, sustained by a prolonged boom period of the world economy.

Comparing the two graphs, once the crisis appeared, it may be noticed that the trend reversed for the two variables, the link between them being reversed. Therefore, not always an increase of the savings rate determines an increase of GDP/capita.

4. Conclusions

We saw in the previous part of this paper how the anomalies appeared in the rationality of the economic growth. The causes we could intuitively detect, in our opinion, may be found by studying behavioural economics. The psychological fundamentals underlying the human behaviour determined the population – who was facing a threat and so was mentally forced – to take precautions measures, in order to avoid being unprepared in the following period. In front of rationality stood this time the preservation instinct.

Another big problem of the models aiming to explain the economic growth and to offer recovering scenarios is represented by the implementation of these models. There are big gaps of the transfer of knowledge between those who develop models (academic world, researchers) and those who are supposed to ensure the smooth running of the economy (both governments and the business community).

In this paper we focussed for the time being on a single moment, but the research will be extended in the next papers, including in our analysis other models of economic growth. Nevertheless, there is one single thing which cannot be challenged, i.e.: the more findings we'll have and the bigger the innovation process (closer to the rhythm of occurrence of these technologies), the more we'll have economic growth.

Acknowledgements

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Note

- ⁽¹⁾ Definition from the Investopedia.com site: <http://www.investopedia.com/terms/e/economicgrowth.asp#axzz1drQ6zThy>.

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The Limit between the Rational and Irrational Behaviour in the Economic Science

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Abstract. *Although three years have passed since the onset of the deepest recession from 1929, the most world economies are still fragile, the slipping into another recession being imminent for many of them. “It is a sin to waste a crisis” without learning something of the causes that generated it, said Nouriel Roubini, but this time the problems facing the economic science are related even to the own concepts of the promoted model, while to change something in the economy it is need a reconceptualization of the economic science.*

The context of the current economic model has failed to anticipate the economic crisis and fails to propose sustainable measure of the economic recovery and this because it starts from the wrong premises, such as assuming that the behavior of the subjects within the market is always rational.

In this work we will demonstrate that the irrational behavior of the participants to the economic life has led to imbalances of these markets and we will try to distinguish between the rational and the irrational economic behaviors, to identify the operating area of economic science at this time.

Keywords: rational/irrational behaviour; economic crisis; financial market.

JEL Codes: G01, G02.

REL Code: 2B.

1. Introduction

“It is a sin to waste a crisis”, said Nouriel Roubini, the great contemporary economist, who was able to anticipate the financial crisis from 2008, probably referring to the fact that it is a pity to haven’t learned something of the causes that generated this crisis (Roubini, 2010).

Although there have passed three years since the onset of the deepest recession from 1929, the most world economies are still fragile, slipping into another recession is imminent for many of them.

The economic science is now in a great dilemma: either to strengthen the conceptual basis to continuing the line of rational ideas or to record a conceptual transformation, reinventing himself.

But as long as the economic models proposed until now failed to anticipate the economic crisis and could not provide sustainable solutions for economic recovery, I think a reconceptualization of the economic science is rather required, which will have to acquire itself the predictive function to anticipate the crisis.

There are many opinions expressed in this sense, as many economists believe that the economic science needs for a new conceptual model and for a new paradigm.

The same opinion is shared by Marin Dinu, who considers that “the economy continues in its mechanistic view, the materiality and not the material, the object and not the subject is matter. But the economic science is not, as believed in some studies, all statements that can be demonstrated as true by calculation and quantitative measurement, but also through the matrix of qualitative appreciation, the economic phenomena having sense only like product of the rational and emotional duality, found in the human nature. It is comes without saying, that we have for classical economics the situation where a significant part of the consequences are not in accord with the hypothesis founding, these contradicting it. Is unavoidable in these parts to produce a radical change of the hypothesis founding to restore consistency with statements about the consequences. Maintaining the vision of the market as an infallible mechanism means to condemn economy to conceptual reverse. The excessive rationalism that created the Economy gives it the explanatory elegance, but empties it of its dual, material and nonmaterial essence” (Dinu, 2010, pp. 46-49).

Liviu Voinea considers that “the standard economic theory – the orthodox theory – seems not to correspond to the contemporary reality: it did not anticipate the global economic crisis and can not explain it convincingly while also fails to provide sustainable measures to overcome this global recession. The current proposed measures throw the world economy into another crisis.

It needs a new economic paradigm and also rethinking macroeconomic policies. Economic models have failed and it was normal to fail because they are based on false premises – the most important thing is keeping the overall balance and have limitations that not exist in the real world” (Voinea, 2009, p. 19).

Akerlof and Shiller also believe that the current financial crisis is not a ordinary one and the traditional remedies applied in these situations will not work: "This recession is different. It is not caused only by the low demand. It will be difficult and perhaps impossible to achieve the objective of full employment if the global loan need falls considerably below its normal levels. In the financial sector, the problems have arisen in the past, too. But now, the crisis is widespread, it involves the whole economy. The crisis was not foreseen and also not entirely understood by the public or by some key decision makers, because there were no principles of classical economic theory to have regard to the animal spirits. Also, the classical theory, which is part of the economic science mainstream, excludes modes of the business behavior that generates crisis, excluding trust, corruption and the role of the stories that we interpret the economy” (Akerlof, Shiller, 2010, pp. 151-168).

Speaking about the “New Economy”, based on deregulation and financial engineering, responsible for triggering the Great Depression of 2008, Stiglitz believes that it should bring us something else, like “*prosperity for all and the end theory of the economic cycles*”. But it was not so and for this reason, Stiglitz says: “*we do not want and we can not return to the world that was before crisis*” (Stiglitz, 2010).

2. Rational behaviors in the economy

As it is well known, both theories that form the so-called neoclassical synthesis the monetarist and the Keynesian theory have focused on the assumption that the natural state of a market economy is to be in balance and the participants in economic life always act rationally, having in view their own purposes.

A statement regarding individual goals is made by Mill, who said that “often distinguishing between the ideal according to which an individual should have the right to have in view its own purposes and the consequence that, let free, he will have in view only his own selfish purposes” (Mill, 1946, p. 70).

Continuing it on Mill, Heyek tells us that “the freedom to follow his purpose is important for the selfless man, on whose scale of values the needs of others takes an important place, as for any selfish. To make your main purpose doing good to the others is part of human nature and one of the essential conditions of happiness. (...) However, the general altruism is a meaningless concept. Nobody can actually concern for the others; the responsibilities that we

can not assume have to be always customized and it may refer only to the persons about we know the concrete things and which we are linked by choice or due to special conditions” (Hayek, 1960, p. 100).

Let's see bellow how is defined the rational economic behavior in a market economy.

The individual behavior is considered “rational” when it chooses “more” instead “less” and “the choices demonstrates consistency”. When the consumer is asked to choose between two packages of goods, one of them containing a larger quantity of a good and a smaller of another in comparison with the other package, the decreasing marginal substitution hypothesis is introduced; (...) consumers will choose the packages of goods that contain a large quantities of any kind of goods, all other conditions being equal” (Buchanan, Tullock, 1962, p. 56).

Rationality plays an important role in any discussion regarding the human capacities of knowledge, decision and action. While the theoretical rationality focuses on our cognitive exercises at the opinions and beliefs level, the practice rationality refers to the ground base, on which our decisions and actions are built. The models and theories of economics science that are part of the current “mainstream”, are based on practice rationality with its two shades, *comprehensive rationality* and *limited rationality*.

The comprehensive rationality assumes that the decider, mainly, has the ability to obtain relevant information (about alternatives, benefits, costs), to process it correctly, and a model based on this kind of rationality, supposes the setting of the preferences and of the output predictability, according to the input of the decision process, which means that the rationally decider, faced with the same options and placed in the identical situations, will make the same choice. This model does not make assumptions regarding its effective use by the deciders, but asserts that the individual has the ability to decide rationally, based on the comprehensive evaluation of alternatives according with the forecasting of the costs and benefits, proposed of each considered alternatives and the decision is to maximize the benefit.

The individual rationality is “on the subject centered” and “supra-individual”, in the same time. It is “on the subject centered” in sense that requires a predefined concept of rationality, clearly defined, unique and accessible, in principle, to any subject, and, on the other hand, is “supra-individual”, in sense that it is not structured or specified by the subject in the decision or action (Macoviciuc, 2009, pp. 377-383).

The limited rationality supposes an optimizer behavior, limited by the contextual constraints, inherent to any real decision. These can be endogenous (limits the obtaining and processing of the information) or exogenous (the complexity of the decision context). As José Antonio Marina says “rationality is

not a tool for modeling and predicting the equilibrium of the world as a whole or to create a general model that takes into consideration all the variables, but it is a tool for solving of any partial and specific needs and problems” (Marina, 2006, p. 23).

3. Irrational behaviors in the economy

We know that in any capitalist economy there are three categories of actors involved in the economic life through a rational behavior, as it's defined above and also by irrational decisions pertaining to the psychological characteristics of deciders, such as preferences, their feelings or emotions. These endogenous constraints together with the exogenous constraints, pertaining to the access and the processing costs of the information, limit the possibilities of rational action of the participants in the economic life.

The three categories of participants on the economic markets there are: the consumer, the economic agent (the trader) and state, in its dual role, both public service provider or consumer and the market regulator, which establishes the rules of the markets.

To understand the economy, we must determine what are the irrational factors causing irrational behaviors and how the economy is influenced by these factors.

There is not a very clear demarcation, in the current economic science, between the two areas of economic behavior, namely the rational and the irrational economic behavior.

An approach which worth mentioning here is the Robert Shiller's assertion, that refers to the link between efficient markets and excessive volatility, that caused a heated dispute on this subject in the early 1980's. Shiller brought more evidence that the capital markets from US were extremely volatile in comparison with the long-term economic fundamental principles. Those debates have resulted in a consensus related on the idea that the markets can be inefficient because they are unable to rationally reduce the future cash flows and the financial asset prices there are often influenced by the behavior, that divert them from the economic fundamentals principles, for a while (Shiller, 1981).

Another approach belongs to Blanchard and Watson, who developed the concept of “speculative agitation” as an explanation for the excess volatility highlighted by Shiller on the capital market. The idea that buying the overvalued financial assets during a speculative agitation can be defined as an rational behavior. For this reason, a decision to continue buying in the hope of greater profits in the future can be a perfectly rational decision (Blanchard, Watson, 1982).

The latest theoretical models attempting to explain the irrational behavior of an investor in the financial market refers to dimension of the risk premiums on the shares and the paradox between the excess preference for the shares versus the treasury certificates (Mehra, Prescott, 1985). For example, between 1962 and 1992 the risk premium was 6.1% in the US, according to a study by Siegel and Thaler 1997, although the economic models of the rational behavior proposed a much lower risk premium.

Another way to research on the rationality of the financial markets is the descriptive – qualitative.

A new group of economists who criticized the quantitative models as a means to analyze the efficiency of the financial market have studied the “speculative agitation” in the past (such as “tulip mania” of the seventeenth century in Holland and the stock market crashes of 1929 and 1987), concluding that the decision to invest is strongly influenced by the latest information (latest information available on the market – the central banks having an important role, as the spreader of rumors, intervening on the market to support a currency or different companies) and this tends to amplify the price movements (Kahneman, Slovic, Tversky, 1982).

Thus, the Dehesa's opinion is that the efficiency rational models of financial markets can not explain volatility of the financial market from the developed economies and less the emerging market decisions, where information is less transparent and asymmetric, giving rise to irrational decisions (Dehesa, 2007, p. 229).

Interesting is the opinion of Alan Greenspan, former chairman of the Fed which, referring to the distinction between rational and irrational on the financial market, says “Maybe, someday the investors will be able to appreciate when the market deviates from rationality and becomes irrational. But I doubt. The innate propensity of the human beings to always oscillate between euphoria and fear, it seems to be permanent. The whole generations of experience do not seem to have tempered this tendency. I would like to think that we really learn from the experience. For example, to the question: What kind of imbalances and problems are looming beyond the predictable horizon?, I invariably answer that seldom the financial crisis can be anticipated by market participants” (Greenspan, 2008, p. 469).

With increasing globalization, people have changed itself, their priorities have changed, their preferences and also their goals have changed. People became more selfish, more eager to make money with minimal effort and the financial market offers this possibility, but only for the owners of capital. The innovations in financial markets over the past twenty years, and the loan

expansion from the productive economy to the consumption have changed the choices of the participants to the economic life.

Keynes warned us long time ago that the economy is governed not only by rational factors, which "as a invisible hand" that will be arranged in any transaction for the mutual benefit of the individuals, as the classics believed, but also he appreciated that a significant proportion of the economic activity is governed by "*animal spirits*".

People have uneconomic reasons and do not always act rational when they follow their economic goals. According to Keynes, the animal spirits are the main cause for the economic fluctuations and also for the voluntary unemployment. Thus, as "invisible hand" of Smith is the key of the classical economics, "animal spirits" of Keynes is a key for a different view on the economy, a view that could explain the fundamental instabilities of capitalism (Akerlof, Shiller, 2010, pp. 15-17).

The "animal spirits" metaphor is coming on Latin pathway and it has a history covering at least 2,000 years. It is believed for several centuries ago that "animal spirits" means "nervous fluid" which makes people can feel and move, like a "spiritual blood" – what today we would call probable "psycho-emotional factors of motivation". According to Descartes, the "animal spirits" are in the blood and are responsible for the muscle movement and for the communication of motion to the brain. Although physical, it seems to play the role of intermediary between body and soul. In a broad way, the "animal spirits" refer to the liveliness and enthusiasm, in other words to the natural mood of a healthy animal. In the economic context, Keynes spoke about the intrepid vigor and vitality that determine people to take bold decisions and to invest money and time in the business initiatives (Akerlof, Shiller, 2010, p. 23).

Starting on the statement of Smith, that the people pursue rationally their economic purposes, Keynes says that people are driven sometimes by uneconomic or irrational motivations. Keynes tried to explain unemployment starting from the animal spirits and from the emotional motivations behind decisions. These decisions were behind the current financial crisis, which is caused by the changing people's feelings, by confidence, by illusions, by temptations, by the desire to get rich quick, by greed and by all the changing stories about the nature of the economy.

According to Minsky, there are facts that moved the feelings of the authorities and corporations from fear to greed, and led to revitalization of the "animal spirits", about Keynes talked, respectively: *the option of Greenspan* – belief that Fed will not allow to happen nothing bad, the proof being the saving of the investment fund, Long Term Capital Management and the monetary policy of the Fed, to promptly reduce the interest rate in the following period to

the crash of the “dot-com” shares; *the boom of Clinton and the small recession of 2001*, that increased the idea that without inflation the expansions could be more robust, and recessions could be benign and short; *securitization*, hedge funds that seem to transfer the risk only to those able to bear it (Minsky, 2010, p. 39).

Starting from his famous taxonomy of financing profiles, Minsky says that during an expansion, the financial statements evolve from a fully funding covered to a speculative funding or even Ponzi type, and for this reason the fundamental instability of the capitalist economy will grow up to become a state of frenzy speculative (Minsky, 2010, p. 23.)

In the economic literature, there are two different kinds of views about the financial crisis (Mishkin, 1991). The first theory is the monetarist, developed by Friedman and Schwartz, who believes that the banks panic is the trigger of the financial crisis, because the massive bank withdrawals in a relatively short time lead to decreasing of monetary reserves and unable to cope with demands and also the tightening of economic activities. As a solution in this case, the monetarists proposed the central banks to take the lead and to become the “creditor of the last resort” as a measure to prevent crisis. This exceeds the neoliberal ideology that promotes the idea of restricting the role of the state in the economy (Friedman, Schwartz, 1963).

So it happened with the economic crisis of 2008: until the outbreak of the crisis, it went on a broad deregulation of the financial system, and after the crisis it was considered that “the banks are too big to be allowed to fall”, and the state, through the central bank, must come to save them.

The second theory on financial crisis belongs to Minsky (1986). Unlike other studies that blame the “shock”, the “irrational exuberance” or “reckless policies”, Minsky argued that the processes that generate financial fragility are natural and endogenous of the system. Minsky rejects the notion of “overall balance” that prevailed economic science as irrelevant in analyzing of a real world belonging to a capitalist economy with complex and overstated inputs and instead of the overall balance, he proposes “quiet period”, characterized by a robust financial system and less innovation. Minsky believes that market forces acting when a system is stable will push it towards instability, which means that, even if they could reach to balance state, this should trigger some behavior reactions which would quickly remove the economy from the balance state (Minsky, 2010, p. 363).

Another approach of the irrational behavior on the market is related to the information asymmetry. Grossman and Stiglitz were the first economists who have argued that the market efficiency is not possible, primarily in terms of information, because the efficiency disturbs the balance. The market efficiency hypothesis according to which the prices reflect all available information and

the informations have a cost would leads, in fact, to the collapse of competitive markets (Grossman, Stiglitz, 1980).

According to Dehesa, the total lack of informed investors is not a situation of equilibrium, because each investor, taking the price as good, has the feeling that he can gain higher profits if he was better informed. The efficient markets hypothesis shows rightly that the information without charge constitutes a sufficient condition for prices to reflect all the necessary information, but is not a necessary condition. Hayek (1945) believes that this statement is a “*reductio ad absurdum*”, because “the price systems and competitive markets are important only when the information has a cost”. According to efficient market hypothesis, the balance is reached only when the information has a very low cost or when investors get accurate information (Dehesa, 2007, p. 219).

David Smick believes that financial markets have always worked under asymmetry of information, saying that “for the financial markets, the world is round and it can not see beyond the horizon. We are always taken unprepared and for that the world has become so dangerous” (Smick, 2009, p. 14).

The information advantage of the debtor in front of the financial institutions leads to the classic problem of the “lemon”, described by Akerlof. The problem of “lemon” takes place in the credit conditions when the creditors have a problem to determine the real risk of the financed project. Thus, when the creditor can not establish with accuracy the risk of the financed project, if it will succeed or not (“lemon” from the Akerlof's example), he will fund that project with an interest rate reflecting the average between a good and a bad project. The result of an such approach is that those who borrow and have feasible projects pay a higher interest rate than they should, and those who have projects with high risk pay lower interest rates. Therefore, the best projects can run out of funding, if those who made it leave the market because of high interest rates (Akerlof, 1970).

Also, the information asymmetry between the agents of the financial markets may lead to moral hazard, which adversely affects their effectiveness. Thus, if the financial institutions do not identify rightly the quality of the projects which want finance it, there is an incentive for customers to prefer activities with higher profitability for them which, though risky, would bring greater benefits in case of success, but in the same time, if they will not succeed, will produce losses for financial institutions (Bernanke, Gertler, 1989).

The recent literature focuses more on the impact that financial structures have on economic activity with respect to asymmetric information between the parties in a financial contract. Thus, it is considered that those who borrow have an advantage of information over those who loan, because they know better the

projects that intend to finance them. Thus, the asymmetric information gives rise to two phenomena: “moral hazard” and “adverse selection” (Dehesa, 2007, p. 221).

“Moral hazard” is seen by the great prophet of the crisis, Nouriel Roubini, as one of the main causes of financial crisis. By “moral hazard”, Roubini understands the exuberance with which the customers gave rush to the bank to borrow to buy housing. In his opinion, the “moral hazard” is the action of the broker that brought to a bank a credit without a proper risk assessment and for this he was rewarded with a substantial commission, although he had no responsibility if the loan became nonperforming (Roubini, 2010).

In another definition less plastic than Roubini’s definition, the “moral hazard” refers to changes in the behavior of the economic agents, when there is an insurance against risk, the change producing in sense of decrease the aversion against risk. The “moral hazard” specific to the present crisis means that both banking and non-financial system expects the state to intervene to restore liquidity in the banking system, or to relax the credit conditions (Dinga, 2009, p. 487).

Thus, “adverse selection” and “moral hazard” increases the possibility of financial crisis, causing serious damage in the real economy, as happened in 2008. Another reason that caused the financial crisis was a lack of regulation of the financial institutions, role that belongs to the state.

Paul Krugman believes that the crisis was not caused by the deregulated institutions that have assumed new risks, but especially by the risks taken over by some institutions, unregulated from the beginning. For this reason, Krugman did not consider a high problem the repeal of the Glass-Seagall Law in 1999, a measure that allowed to commercial banks to engage in securities transactions, specific operations to the investment banks and to take more risks. The main problem was the shadows banking system that increasingly expanded, exceeding at some point the regulated system. Krugman accuses politicians and officials for not extending regulations and “financial safety net” to cover these new institutions, saying that “any institution that acts as a bank, and that have to be saved in crisis as the banks, should be regulated as a bank” (Krugman, 2008).

Stiglitz speaks about the existence of a “toxic combination” that led to the crisis, that consists among others of: the existence of a deregulated market with excess liquidity and low interest rates, a speculative bubble on the real estate market and the exponential rate of credit in substandard conditions. Stiglitz believes, however, that these three lethal combinations to unbalance a market are linked in the sense that the existence of a deregulated market with excess liquidity and low interest rates influenced the credit and the excessive and substandard loan, led to a speculative real estate bubble, that caused the economic crisis when it has broken (Stiglitz, 2010).

According to the two great economists assertions, we can conclude that insufficient regulation of financial markets was one of the main reasons that favored the financial crisis of 2008. The economic science, based on neoclassical doctrine, that supposed the rational behaviors on the market, promised us only balance and welfare, but instead we got the crisis and imbalances. For this reason, we conclude that the decision to leave deregulated the financial markets can be considered as a part of the irrational behavior.

Although there were warnings in this regard, the political decider makers had not taken it into consideration. Keynes talked about the role of the government in our economy to prevent the excesses consumption, due to the emotional states, respectively the animal spirits. Thus, left on their own to adjust alone, “led by that invisible hand”, the capitalist economies will hunt the excess, will create anger, which will be followed by panic. People will consume too much and will save too least. And, in this case, the state must intervene (Keynes, 2010, p. 150).

At the limit between rational and irrational behaviour, we also could consider the “corruption”, which are seen by Daniel Dăianu, near the immoral conduct, as “features of the institutional fragility and lack of democratic references that are specifically especially in developing countries. Most post-communist countries in transition were, by definition, included in this category” (Dăianu, 2009, p. 58).

Another aspect we want to approach here is the “informal sector” of the economy. As we know, most of the world economies, especially developing economies, are characterized by the dual character of the economy, which includes both formal and informal sector. To define the dual character of the economy we can mention the statement of the Hart, which considers that some economic activities and enterprises are formal in sense that they take place in the framework of the official legal structures and of the special regulations, whereas the other “take place beyond the effective state regulation” (Hart, 2001). In the literature, the formal sector is alternatively called modern, urban, good jobs, industrial, while the informal sector is alternatively called, agricultural, traditional, bad jobs, rural (Field, 2009).

We want to establish in this paper if the options for informal sector is a rational behavior or it can be considered a irrational decision.

In the informal economy may work the enterprises, employing informal labor or unfolding commercial activities “behind of the certain state regulations” as Hart noted, and also individuals who can enter on the informal labor market.

Fields says that the most common characterization of the informal sector is that it is an easy-entry sector where workers can enter to earn some cash preferring to earn nothing. The important features of the labor market dualism, described above, is that the formal sector offers attractive wages and work conditions, while the informal sector offers the unattractive ones. This leads to

the first characterization of the informal economy: “workers prefer the formal jobs and accept to work informally only as a last resort (Fields, 2008).

We see, thus, that the decision to choose the informal economy sector is based on an analysis of cost/risk opportunity and is just an alternative to the formal sector and for this reason it could be considered a rational decision.

The informal sector of the economy remains outside of economic science at this moment, there are no economic models and theories that take into consideration its size, although there are many studies that measured the size of the informal economy in different national economies. The role of the economic science must be not only the development of the measures to eradicate the informal sector, impossible to do, but also the design of economic models and theories that take into account an acceptable level of informal economy, which has the role to take the shocks from the formal economy.

Participants of economic life: enterprises, consumer, State

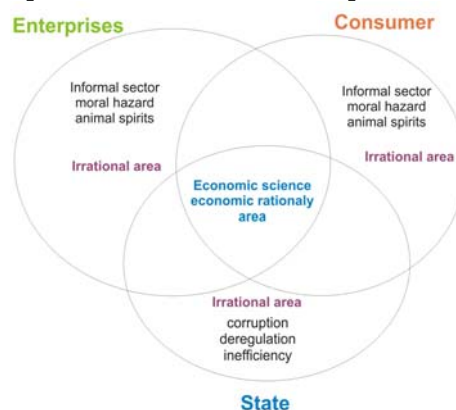


Figure 2. *The limit between rational and irrational in the economic science*

Figure 2 illustrates the inter-subjectivity between participants on the economic market, namely: company (enterprise), consumer and state, delimiting the rational of the irrational areas, revealing, thus, the operating area of the economic science at this time.

4. Conclusions

As we can see from Figure 2 presented above, the operating area of the economic science at this moment is extremely small, and it is located at the intersection of the rational decisions (behaviours) of the participants at the economic life, respectively enterprise, consumer and state.

We have the following conclusions: the participants on the economic markets do not act always rational; their decisions were influenced by animal spirits, moral hazard or irrational exuberance; they can choose the informal sector of the economy; the state is characterized by corruption, inefficiency and can be accused of insufficient regulation of markets.

Taking into account all these aspects, I believe that the economic science should undergo a conceptual transformation at this moment of time and the factors listed above which are the attribute of irrational behavior should become assumptions for the future economic models and theories.

The current economic crisis has shown that the neoclassical theory applied till now could not find the viable solutions to get out of the crisis and the currently macroeconomic models have proved itself to be wrong, because they left from the wrong premises like “overall balance” theory. The experience shows that on any type of market the “overall balance” appear seldom, accidental, because the natural state of any market is imbalance, produced by the factors mentioned in this work.

In this regard it could be updated the heterodox economic approach, initiated by Joseph Schumpeter (who believes that the economy is in a constantly evolving due to technological progress and financial innovations that disturb the balance state), and the “Evolutionary Economic Theory”, developed by Nicholas Georgescu-Roegen, whose basic principles are: the normal state of markets and of the economy like a whole is imbalanced, that means the aggregate demand is not meet with the aggregate supply on the equilibrium level; the economic agents are not always rational, and the results of their actions are unpredictable. The economic decisions are not determined rational, it is influenced by the human psychology, which may be motivated by trust; the economic crises are inherent and endogenous, it comes from inside of the economic system, and are not determined by external factors such as neoclassical theory says.

We consider necessary that the future economic theories and models to take into account the principle that the natural state of any market is the imbalance. Also, to reduce the irrationality area we propose: a better regulation of the financial system, a low corruption in the public system and decreasing the share of informal sector, particularly in developing economies.

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The Bureaucracy in the Current Economic Climate

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Abstract. *In recent years the bureaucracy has become a topical subject. Therefore this study aims to analyze the problems of bureaucracy and the effects it can have on the current economy. Given the current economic context, Romania is going through a turning point, and the bureaucracy in our country may have a hard word to say about the future. The conclusions of the study aim to come up with some relevant solutions regarding the elimination of the negative effects of bureaucracy.*

Keywords: bureaucracy; public institutions; transparency; communication; document management.

JEL Codes: B00, D73.

REL Code: 5K.

Introduction

In the current economic climate, bureaucracy began to play an increasingly important role. Given the fact that bureaucratic phenomenon has made its presence felt throughout history from the beginning of the first civilizations (the Roman Empire was known for his many public institutions which collects through their officials fees and taxes on behalf of the king, public institutions that also offered various approvals to proceed certain activities) and to this day, it is hard to believe that at present this phenomenon has not an important role on social and economic progress.

Currently all activities in Romania are in direct contact with the bureaucracy from the public institutions, a phenomenon that our country's economic development can not escape.

Thus, to have a competitive economy in Romania would be important that the main problems created by the bureaucracy (the ineffectiveness of civil servants, the lack of communication at the internal and external level from public institutions, rules and regulations that hinder the proper performance of public institutions and hence the activities of the private sector, the lack of transparency in decision-making) to be improved or even eliminated. From this point of view if there are created the premises of a harmonious economic development, there are more chances that Romania can pass more easily the problems created by the economic crisis.

Bureaucratic phenomenon is not an actual problem of modern society because it was studied and analyzed for a long period of time by specialists. They wanted to observe the main features of bureaucracy, but they also analyzed the positive and negative effects that bureaucracy can generate.

The main scholars who came with relevant analysis, studies and observations in this area are: G. Mosca, R. Michels, M. Weber, Ludwig von Mises, G. Tullock, J. Bichanan, A. Downs and W. Niskanen.

Current status of research on bureaucracy

J.S. Mill analyzed bureaucracy and emphasized the contradiction between democracy and bureaucracy, focusing on the idea that in all systems based on bureaucratic procedures it has been a steady trend towards empowerment of civil servants and to transform them into a separate category that tends to reproduce and to assert their own interests through the exercise of power.

G. Mosca was among the first to research the phenomenon of bureaucracy, analyzing the historical aspect of this phenomenon resulting in a description of the centralized state formations – from the great empires to modern states – as systems dominated by bureaucracy and inevitably lead by a minority political class.

In the case of R. Michels the concept of bureaucracy has been expanded from state parties to political parties and he described the phenomenon of increasing the power of the political leaders by using bureaucracy in the organizations they are driving.

Fundamentals of an explicit theory of bureaucracy were made by M. Weber. Because most of the professional studies and researches in this area are the landmark studies of the German sociologist he is considered the “father” of bureaucracy. In his many studies and researches, M. Weber used the tools of sociology to analyze the general characteristics of the departments (bureaucrats bureaux), but also the behavior of the bureaucrats (civil servants) from the public administrations. He was going on the premise that the increasing of the bureaucratic organizations is resulting from their efficiency in accomplishing complex activities. For M. Weber the perfect bureaucratic system was an organizational system where the power was based on competence not on force or tradition (Weber, 1978, pp. 25-30).

Ludwig von Mises proposes one of the first economic analyses of bureaucracy and also he observed the main differences between bureaucracy and profitable organizations and unprofitable organizations. He has shown that government bureaucracy will be unable to engage in an economic calculation and thus will suffer from significant inefficiencies (Coyne, 2007, pp. 11-12). Therefore, Ludwig von Mises made a clear distinction between bureaucratic management and profit management.

In the case of G. Tullock we can say that he has provided a detailed analysis of the nature and limits of bureaucratic structures and he has focused his attention on public bureaucracies emphasizing the personal relations and the way bureaucrats advanced in these organizations. G. Tullock has made an important distinction between political and economic relations. In this case bureaucracy is placed in a position of a producer which has to maximize his production in the constraints given by his limited resources (Coyne, 2007, p. 12).

J. Buchanan and G. Tullock are putting the foundations of “public choice” theory through which they formulated a new theory of bureaucracy and the political market, theory in which they criticized the omnipresence of the state in the economy. They came up with a new momentum of research concerning the application of economic principles in areas considered outside the economic game like the case of the public administration, research that is using traditional microeconomics to analyze individual and collective decision process, to assess the comparative efficiency of the market and state, to assess bureaucrats motivations and to interpret an ambiguous concept such as social welfare (Buchanan, Tullock, 1995, p. 31).

A. Downs defined a series of concepts for the study of the bureaucrat economic behavior, social behavior and political behavior such as: convenience and public interest. Along with G. Tullock, A. Dows has done an economic analysis of bureaucracy that is placed in a position of a producer that must maximize his production in the constraints given by his limited resources.

In the case of W. Niskanen, he introduced a new concept in “public choice” theory, namely the budget maximization model through which he examines rational choices in public administration. W. Niskanen believes that rational bureaucrats will always try to increase their budgets because they want to increase their own power; thereby the bureaucrats are contributing to the growth of state power and they reduce social efficiency. W. Niskanen considered that the allocation of a good or service in the public sector can lead to increasing the amount of their production rather than their efficiency (Bierhanzl, Downing, 1998, p. 175).

In the current literature bureaucracy is seen in various forms (an organization based on strict rules and regulations or a form of an “heavy” hierarchical organization and with lacks of transparency in terms of taking certain decisions), but most researchers from this field of activity are trying to find solutions for the bureaucracy to become more efficient in the economic activities or replace it with another form of organization more efficient. Thus, researchers like Song Zang believe that: bureaucratic systems are those that use mass production with some losses, while high performance systems prefer to reduce production losses in the system (Yang, 2007, p. 3), and Hilarious Berger believes that: bureaucracy is a form of organization that is based on strict rules and powers attached to positions and bureaucrats are making their decisions by processing information with respect to predetermined laws (Berger, 2007, pp. 386-387).

In his study of bureaucracy C.J. Coyne believes that bureaucracy refers to all forms of non-market organization. Among other things, in this general category are included government agencies and internal organizational structures of many private companies (Coyne, 2007, p. 11).

In terms of making the bureaucracy more efficient or even replace it with other forms of management in the research of J. Toye (“Modern bureaucracy”) it is introduced the idea of a non-bureaucratic bureaucratic organization (Toye, 2006, p. 3). Other authors, such as Maija Halonen-Akatwijuka and Carol Propper, believe that privatization is not the only solution that governments can take, which can lead to increasing efficiency in the public sector. Many politicians have tried government reforms in social services such as health and education. A model for this purpose should be to create a government agency whose sole purpose is the administration of a single complete program (Halonen-Akatwijuka, Propper, 2007, p. 1).

Today, through research and analysis dealing with the issue of bureaucracy it can be seen a tendency to search for relevant solutions through which the harmful effects of the bureaucratic system to be removed and eventually a change of rules and regulations that guide current bureaucratic system so that it becomes much more efficient than it is in present.

The effects of bureaucracy

Romania is recognized as a country where bureaucracy is taking over the control in the most areas of activity (health, legal system, education system, banking system, etc.). There is currently no Romanian public institution that can escape the “heavy” bureaucratic system which presence can be seen in generally in their activity.

Besides such problems faced by the employees of public institutions at certain times of their activity it is possible to occur some organizational problems that can develop the bureaucracy from those institutions. In terms of working with the external environment, the bureaucratic system of public institutions lead to a complete lack of cooperation between public institutions and the external environment (investors, citizens, businessman, other state institutions).

These problems usually occur when any interested person to perform a certain activity or wants to know some information's enters in contact with the Romanian bureaucratic system. The main problems and effects created by the bureaucracy that the public institutions are facing are:

1) Overloading departments with civil servants.

There are many people in one department that must do a single service task or solve a single problem. But if a problem must be solved it is required to pass almost every person in part from that department and in these case many persons are losing valuable time. In this case the assignments of civil servants and problems can be solved by using fewer civil servants.

Also in this case we can speak about the costs from the state budget with the salaries of the civil servants who provide some activities that in a more efficient system would be provided by a much lower number of employees in this domain. Still we need a solution in this situation because the dismissal of civil servants that are in excess is not an effective solution now (the civil servants who are dismissed will receive unemployment benefits, but this solution can also lead to a decrease in consumption - Romania now has an economy relied heavily on consumption).

2) The “traveling” of documents.

In most cases many people, both employees and those who come into contact with them are bound by the bureaucratic system in which they operate to travel with all kinds of documents and files from one department to another

or from a state institution to another with different purposes. This can hinder the proper performance of the Romanian public institutions and efficiency in terms of solving some problems. The time that is lost in these situations can lead, for example, to huge loss of money to persons who submit their documents to attract European funds. It can be concluded that one of the reasons that the absorption of structural funds on September 30, 2011 is only 14.13% (source: www.fonduri-structurale.ro) is the Romanian bureaucratic system.

3) The lack of communication between public institutions, their departments and between civil servants of the same department or office.

In this case unpleasant situations may arise where some people may suffer from a lack of transmission unclear or insufficient information or the transmission thereof between public institutions, departments or between fellow employees in the same department. This may occur also in the case when the information is transmitting between superiors and subordinates and vice versa. Thus, there may be many problems that can lead to lower efficiency of their activity due to lack of communication both vertically and horizontally. In the case of an efficient communication, information should be processed and distributed to the hierarchical levels or to the departments and their use should lead to solving the tasks that are dealing with the public officials or to solve some problems, but this phenomenon is suffering a lot now days. This information that should be sending by the departments or civil servants from the same office should be characterized by objectivity and timeliness. There are cases when information is communicated with a delay of a few days.

Similar situation happens in the communication between public institutions where gaps occur in the same communication and collaboration between them. Rules and regulations which the public institutions (bureaucratic institutions) must strictly comply lead to many inaccuracies of communication order, these having direct effects on growth performance in economic activities.

4) The lack of transparency.

Another problem faced by public institutions is the lack of transparency. This is typical situation for all bureaucratic institutions and is manifested by lack of information provided to those directly interested in a particular issue or providing incomplete information. Bureaucrats (civil servants) profit by the status they have and the information they have (even if this information is usually public) and they can have in this case some power over the others. The lack of transparency in the communication of the public administrations can lead to the increase of the corruption.

5) Loss of documents.

Due to a lack of organization and most of the time the inefficiency of the bureaucratic system (old rules and regulations), there are unpleasant cases when some documents are lost, or to wander during the circuit that the documents are

making. Also, due to lack of organization and storage of documents in different locations unsuitable for them, they can easily lose many of them, and also they can easily damage or lose. Thus, the costs with searching and remaking the documents are too high for the institution and the default budget.

6) The reticence in using modern technology (computer, performance operating systems, advanced software, etc.) for administrative tasks.

Many bureaucrats from public institutions consider that the best way to perform their tasks is the use of the same rudimentary techniques they used when they were hired. Many such persons have a higher age (over 50 years old) and considered unnecessary the use of modern techniques mainly due to the mentality. This behavior leads to a low efficiency for the staff of public institutions and major delays in carrying to the end their tasks. These public servants are trying to oppose the use of modern techniques because they don't know or they don't understand that modern techniques can help them and facilitate the work they do and remove routine that can occur when carrying out administrative activities.

It can be seen that the bureaucracy that exists now in the public institutions in Romania can lead to many losses in financial terms (for example loss of direct investment or loss of EU funds). In the current economic climate these losses affect the economic growth.

Conclusions

Observing the negative effects on economic development from nowadays created by the bureaucracy it is necessary to take certain measures to eliminate the problems created by the bureaucracy especially in attracting foreign investments and European funds.

With a more "flexible" bureaucratic system the economic growth from Romania can be helped to develop.

First, to eliminate the existing problems in the bureaucratic system from Romania must be implemented a document management system through which to achieve a reduction in spending the money from the state budget (there are high costs in finding the lost documents or damaged documents and the lack of efficient communication between state institutions or departments of the same institution) and a reduction in waiting time from citizens, businesses and investors in obtaining information.

Secondly, there must be a high transparency in the provision of public information from the public institutions. If this information is posted through communication channels that everyone can access (bulletin boards, web pages) it would eliminate many of the problems faced by potential investors. In this sense all public institutions should provide the following information: documents needed for submitting aimed solving specific problems (approvals);

periods and the schedule when must be submitted the documents; information about the domain of activity of that institution; data on the amounts of local taxes (for example the municipalities) and how that money is spent; the implementation of a computer program through which interested parties can have access to certain statistical information.

In conclusion, if Romania would remove some of the problems created by the bureaucratic system, our country would have a much higher competitive advantage in terms of attracting foreign investment and European funds.

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Analysis of the American Economic System – from the Old Capitalism to the New Capitalism

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Abstract. *In the past years, the globalization has generated a significant development of the emergent economies, but also that of the level of the developed countries. As it is easy to notice, we are the spectators of an ever more “globalized” world which does not lack numerous risks. Starting with the inequality between the people, continuing with various social problems and ending with the “creative destruction” of some countries’ economies, an inevitable and irreversible destruction after entering into this game, the globalization phenomenon has become a threat.*

The globalization has opened, in the absence of economic protective policies, the way of frequent economic crises. The present crisis has taught us that the governments of the countries should play a more active role in the co-ordination of the economic policies, striving to prevent unbalances as those registered already and to avoid crises.

Keywords: economic policies; political power; freedom; wealth; globalization; financial markets.

JEL Code: E20.

REL Code: 11B.

Introduction

Starting from the book of J. Stiglitz *Freefall: America, Free Markets, and the Sinking of the World Economy*, published in the year 2010 by the publishing house W.W. Norton & Company, one can identify important aspects of an economic system model, proven to be not competitive, reaching a dramatic position, beginning with the biggest world's economy. This book represents another clarifying study for the present world-wide financial crisis, written by the Nobel Prize laureate for Economics in the year 2001 and former adviser for economic problems during the Clinton administration⁽¹⁾.

From the beginning of the crises there were drawn up many interesting studies concerning the present economic crisis, but Stiglitz certainly remains one of the most authorized voices with regard to this subject. These could be divided into two categories – one that presents internal aspects, focusing upon the decline or salvation of various financial institutions, such as the book of Andrew Ross Sorkin, *Too Big To Fail*, or enlarging the area of analysis of economic theories representing the basis of the present economic system proven to be not competitive, identifying the causes and offering possible solutions that could avoid the repetition of the same mistakes. In this last category are included the works of Stiglitz, mentioned before, and John Cassidy, *How Markets Fail* (2009).

The title of this study, „Freefall” is one very well chosen by the author, because it includes two key words of the economic theories: free – the equivalent for freedom, one of the most precious assets of a person, but also fall – collapse, that can be considered as one meaning recession or decline in economic terms. This combination free fall or, why not, „decline caused by the excess of freedom” are particular metaphors helping to identify and characterize what it is happening with the American economic system.

Making an incursion into the domain of physics, an object in free fall is under the influence of a single factor, i.e. the gravity. In the absence of a force that could stop or damp the fall, nothing else prevents the collision with the soil. Moreover, the speed of an object in free fall increases as the object approaches the earth. We could say that the absence of an intervention or an inefficient intervention in the economies being in free fall leads to nothing else but disaster.

An American lead writer, Eric Falkenstein, says that the subtitle of the Stiglitz's work should be sooner “why the free markets are like the religious fundamentalists”⁽²⁾, being given the author's affinity with the expression market “fundamentalism”. In the book one can remark the critics of the present capitalism, this being a concept explained by Stiglitz through the term of „free

market”, a market which is in free fall, in an extreme decline. The present article is only an invitation to read Stiglitz’s book, in order to understand the origins and the causes of the present crises and to overcome the barrier of the unknown with regard to a not competitive economic system.

“Freefall” – main ideas

Stiglitz’s book identifies the origins of “The Big Depression”, intensely criticizes the policies initiated in order to cope with it and offers alternative remedies for future policies that could better handle a crisis from its early signs. What the book has in common with many other studies, written upon the same theme, is the acknowledgment of the fact that the American economic system is in collapse, it stopped being competitive, and can be fixed only by examining the theories upon which it is based. Because until now these theories have not been the subject of a serious debate, this has led to what the author describes as „bubble capitalism” (Stiglitz, 2010a, p. 26).

There are some aspects which Stiglitz shares with other authors concerning this subject. One of these is the effect that the 30 years of dependence upon the economic theories of the free market⁽³⁾ (market fundamentalism) had upon the whole American economy, in contradiction with the lessons taught after “The Big Depression” of the 30’s. Another aspect is represented by the „re-arrangement” of incentives in the financial services of the economy, incentives that have prioritized the short term performance, over the reaching of long term social objectives. Another one is the political power that the industry of financial services exerts upon the carrying out of the economic policies, but also the inherent conflicts of interest, which such a power places above other various challenges and with which nor the legislative or the executive power has been confronted until the present crisis. In other words, all of the above mentioned aspects have represented, and certainly still do, challenges of the American economic system, unheard-of and difficult to meet given that the executives have not the necessary desire to do so.

If we would make an historical analysis of the economic policies embraced by the American government leaders starting with “The Great Depression”, we could learn a lesson, that, through a late understanding, would underline the nature and the causes of what one could name as an extreme failure of the market.

In the next paragraph can be identified the extreme failure of the market: „The United States will have regulation, just as government will spend money on research and technology and infrastructure and some forms of social protection. Governments will conduct monetary policy and will provide for

national defense, police and fire protection, and other essential public services. When markets fail, government will come in to pick up the pieces. Knowing this, the government has what it can to prevent calamities. [...] In America, too many of the rules were set by and for those from finance, and the referees were one-sided. [...] Can we expect even to restrict the banks from engaging in excessively risky behavior?" (Stiglitz, 2010a, p. 97).

The above paragraph is essential in analyzing the American economic system. As we can notice, there are some key words underlined, precisely for a better identification of the causes leading to this extreme failure of the market. By his critic attitude towards the adopted economic policies, Stiglitz denounces the present capitalism, militating through his book in the favor of rethinking this economic system. This is done across the entire contents of the book, where it is presented as a speculative non competitive system, based upon commissions and speculation.

Even the rules of the monetary policy are put into discussion, rules that for the most part are made by and for the people in financial industry. In other words, the author's critics with regard to the carrying out advantageous economic policies for the financial domain underlines an error of the economic system, which is not based exclusively upon the finances. We could notice the author's attitude concerning the fundamentals of the real economy. According to the presented elements, the focus has to be moved from the monetary policy to the real economy. It is difficult to change an economic system, but is much easier to try changing the theories on which it is based, therefore it is absolutely necessary to return to the drawing board in order to succeed an adequate rebuilding/correction of the system.

"Today, the challenge is to create a New Capitalism. We have seen the failures of the old. But to create this New Capitalism will require trust - including trust between Wall Street and the rest of society. Our financial markets have failed us, but we can not function without them." (Stiglitz, 2010a, p. 94).

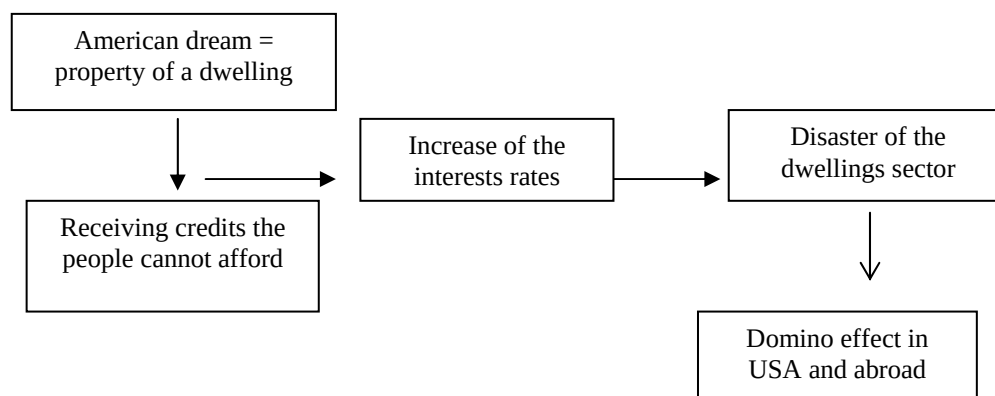
The present capitalism has to be dismantled, but the creation of a new capitalism, although it is a challenge and a necessity, is supposed to have trust as a fundament, trust in its economic system. The critic of the financial system is severe and, although the financial markets have betrayed our trust, they remain necessary for the operation of the New Capitalism. The financial markets have failed, but the fault was of those who established the rules, i.e. those who carried out the economic policies, and the fundament of this economic system was a wrong one.

Stiglitz criticizes the financial system, but goes further with regards to the inability of the markets to function properly and to correct themselves.

No supporter of capitalism and partisan of the role of the invisible hand can “advocate that the surrogate capitalism – reached in the United States could be one efficient or correct, or one leading to the wellness of society” (Stiglitz, 2010a, p. 328).

Another important aspect is represented by the critique of the American system, which is based upon speculation, high commissions, a Wall Street critique, a critique of the Bush administration, and even a critique of the Obama administration. Much more valuable is the idea of recession of freedom, a decline of this right, a violation of the American people’s right to be free. This economic system has generated overpaid bankers and brokers, rewarded for their mistakes, that fed and generated additional needs for the American individual (by offering him/her credits, even when he/she was not eligible), violating his/her freedom and transforming him/her from a free individual into a person chained up in the economic system, a slave of the banking system based upon speculation and huge commissions.

Therefore, the giving of toxic mortgage credits, credits given to persons not fulfilling the crediting conditions, credits secured through their transfer to foreign investors, in order to share the risks and obtain a better absorption, have led to the collapse of the American economic model, based upon speculation. Its basis is presented in the Figure 1.



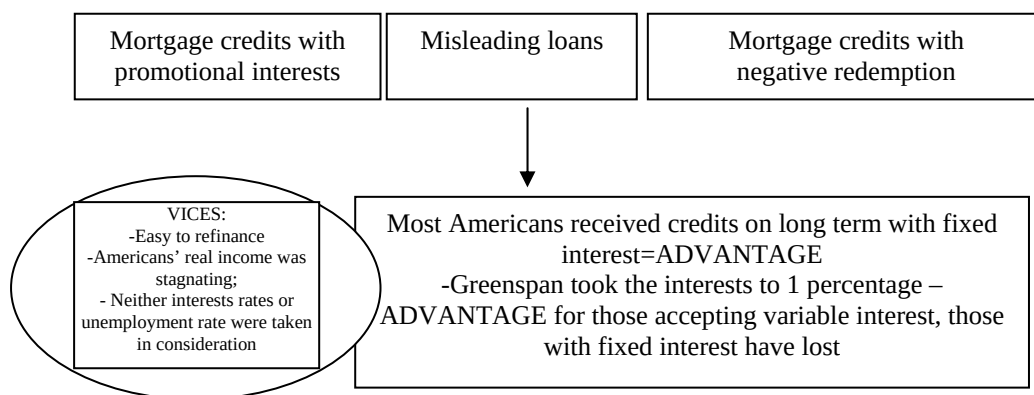
Source: Joseph Stiglitz, „Freefall: America, Free Markets, and the Sinking of the World Economy”, Chapter 4.

Figure 1. The failure of the economic model based upon speculation and deregulation

The lack of professionalism among credit brokers, who presented and faked data concerning the applicants’ incomes, with the purpose of meeting the

crediting conditions, the applicants' lack of information with regard to the risks they took by soliciting said credits, the banks succeeding to create needs and desires many of them didn't have, the bankers' lack of professionalism and greed, plus the absence of regulation to maintain the economic stability, represent the "parasites" that "have infected" the financial markets of the American economic system.

All of these have represented negative instruments leading to this "free fall". They are presented in Figure 2:



Source: Joseph Stiglitz, „Freefall: America, Free Markets, and the Sinking of the World Economy”, Chapter 4.

Figure 2. The mortgage swindling - characteristics

The markets represent the vital centre of a successful economy, but they must not be left free, and the State has to play a regulator role, particularly for preventing situations such as those already occurred. “Perhaps Adam Smith was not completely right when he said that the markets lead the society, with an invisible hand, towards prosperity. But no defender of Adam Smith would dare to say that surrogate capitalism – reached in the United States could be an efficient or correct one or leading to the wellness of society.” (Stiglitz, 2010b, p. 325).

Many times in economic studies, an association between the political power and the economic one is present. An economic system and the political power have to be in a tight relationship, a balance, precisely for succeeding in maintaining stability. Unfortunately, in USA, this balance has been broken, which has also spread beyond its borders. The globalization phenomenon has emphasized this unbalance.

The unbalance means a state opposite to order. An unbalance represents a state of uncertainty, where one of the economy components becomes

inefficient, although on the surface it seems to be very beneficial to the economy, it is a state of maximum vulnerability for the economic system. In the USA, this unbalance has been created by the “vulnerability” of markets, by the lack of their regulation. The financial markets seemed to be very productive, bringing benefits and growth, but the fundamentals were wrong, they were “corrupted”.

“The American empire” is an economic system that before the crisis offered credibility, precisely because the USA were the first economic power in the world. Nobody doubted the USA’s capacity to manage the risks, but it wasn’t so. The risks have poorly managed, the models were wrong, and obtaining a large sum of money within the shortest period of time was the main objective of the agents. The globalization has imposed a very high rhythm of adaption to various economies.

The present crisis has demonstrated that irrespectively of the size of the economic system, even that of an empire, the unbalances occur and develop, if there is not a tight connection between state and the economic environment. This crisis demonstrates that both models, the Anglo-Saxon one, based upon “laissez-faire” and freedom of markets, and the European one, of the welfare/social state, proved to be imperfect, limited and crises generators.

Many authors have written about the existing crisis, but few of them have also offered solutions from the theoretical point of view, not only the practical one. For example, in his book *Economy of crises. Flash course about the future of finances*, Nouriel Roubini says the economic system needs a new essence, even a new economic model. The proposal made by N. Roubini is based upon a model of market economy, where the government provides the necessary public services and where a “healthy” prudential monitoring of the economy and of the financial system exists (Roubini, Mihm, 2010, pp. 9-15).

Stiglitz and Roubini share common ideas with regard to the economic system based upon a corporative capitalism. Roubini also sustains that this present capitalism should be changed radically. Analyzing the ideas of both economists, one can say that Roubini has a more critical attitude than Stiglitz, he wants a radical change of the system, while Stiglitz wants a return to the fundamentals of the economic theory, that favors the rebuilding of a New Capitalism.

The crises are benefic, because they bring changes in the area of policies and especially in the one of ideas. If Roubini says that a crisis should not be wasted, Stiglitz bring concrete arguments, mentioning that if the right decisions will be taken, the effects of the crisis will be diminished and a new crisis will be avoided. If the taken decisions are wrong then the society will have the most to

suffer, dividing itself even more, with the economy becoming more vulnerable, lacking any order.

The critiques brought by the author to the economic system are:

- lack of regulation concerning the issuing of toxic credits;
- deregulation done in such a way as to easily allow bankers to issue toxic credits;
- counteracting the persons kept responsible for solving the problems within the financial industry;
- the adoption of some inadequate measures, like the reduction of the interest rate to one percentage, which lead to a speculative bubble;
- the incompetence of the banks in estimating the risks;
- the conservators' attitude, according to whom the State shouldn't be involved in financial activities to help the population.

The remedies offered are concrete ones, resulting from Stiglitz's especially critique attitude with regard to the economic system:

- the financial bailing of the loans givers, as way of controlling the forced executions;
- solutions in favor of population – for the salvaging of dwellings – without bailing out the crediting banks which should be forced to support the consequences of the fact that they didn't properly estimated the risks;
- solutions to support the population to return the loans;
- loans from State with a very small interests or even zero for putting at the population's disposal a not so expensive credit; this should be translated in a gain for the State and the population, but not for the banks;
- the State should maintain a full employment and a stable economy, promote innovation, provide protection and social insurances and prevent abusive exploitation (Stiglitz, 2010b, pp. 326-331).

Conclusions

Before acting, the economists should rethink the fundamentals of the economy and to ponder on the correctness of the economic theories. We are witnessing radical economic changes, the end of certain economic cycles.

The used pretext, namely the Stiglitz's book, shows that if not kept under control, this unbalances will generate other mutations, even more serious ones. The substantiation of some correct ideas is important, learning lessons from crises, because in time the crisis will disappear and only its consequences will

persist. “The battle of ideas” represents our legacy, a diary which we may have to open again anytime, because the market economies are in a constant change and a continuous struggle.

The ideas presented are only some among the most important ones with regard to the American economic system, an empire which right now is unbalanced. The main idea brought in debate is that of “dismounting the present capitalism”, and returning to its fundamentals in order to rebuild a new capitalism based upon trust. The keywords such as power, order, globalization, fundamentalism of the markets, freedom are cleverly used by J. Stiglitz in his approach with arguments. These key words represent forgotten values or used in a distorted way by the American type of capitalism, a thing that has created a clear unbalance, its result being the “free fall” of the entire economic system.

The present crisis offers with no doubt one of the most useful lessons about a dynamic world that fails too frequently, and should make aware both the ordinary citizen and the deciding factors of the economic policy about the risk of getting prosperity at any cost.

Notes

- ⁽¹⁾ Joseph Stiglitz is the laureate of the Nobel Prize for 2001 for economics, president of the Council of Economic Advisers, vice-president and chief economist of the World Bank, teacher at Columbia University.
- ⁽²⁾ *Stiglitz's Freefall* By Eric Falkenstein Mar 3, 2010 (Author's Website: The subtitle should be “why free market types are like religious fundamentalists”, because he loves using the cute phrase “market fundamentalism” the way MSNBC uses the phrase ‘tea baggers’).
- ⁽³⁾ Concept created by the School of Chicago, used especially under the Reagan administration.

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The Economics of State Aid Control in the European Union during the Financial Crisis: the Challenge for a Post-Crisis Rhetoric

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Abstract. *The present paper explores the rationale behind the legal framework regulating the use of state aid by the member-countries of the European Union during the financial crisis. Starting with 2008, the massive interventions in the banking industry of the governments of the member-countries attempting to eliminate the effects of the crisis fundamentally challenged the core logic of the entire policy regarding the control of state aid in the European Union. We attempt to underline the extraordinary dimension of the impact of the financial crisis on state aid control and scrutinize whether the underlying principles of the state aid regime have been changed. We conclude that the special place that the financial industry in general, and the banking industry in particular, enjoys from the point of view of competition policy, is unfounded. European Union is, after the crisis, in the uncomfortable position of re-legitimizing state aid control.*

Keywords: state aid; competition; European Union; financial crisis; banking industry.

JEL Codes: G01, G18, G21, P51.

REL Code: 17F.

The enforcement of competition law to the banking industry is apparently an old issue of interest for economists. As Adolphe Berle pointed more than a half century ago, “Application of the anti-trust laws to banking [...] becomes a subject of major practical importance” (Berle, 1949, p. 549). It is debatable whether such an observation was actively pursued afterwards. But, as opposed to the experience of American anti-trust policy, the most important aspect of such an issue for the European competition policy is related to the impact of state intervention in the banking sectors. The anticompetitive business practices of the banking institutions have had a less important place in the attention of the competition authorities.

The current financial crisis which started in 2007 and exploded in Europe in 2008 has lead however to massive intervention of public authorities in the economy. Moreover, the financial sector has been the central focus on such an intervention, “the scale of the financial and economic crisis that broke out in the autumn of 2008, and the systemic risks associated with it, were such that Member States used unprecedented amounts of State aid to the financial sector” (Larosiére, 2009, page 6).

All the Member States of the European Union have taken significant steps in the direction of intervention. The amount of aid is unprecedented, even according to the figures supplied by the European Commission. It reaches – at least the state aid pledged ex ante – to 30% of European GDP. In fact, those states that didn’t take any action (Bulgaria, Czech Republic, Estonia, Malta and Romania) have a negligible proportion in the financial assets at the level of the European Union (under 1%) (European Commission, 2011, p. 36) and they are countries whose banking sector is dominated by foreign subsidiaries of large European financial groups.

What is a crisis?

The commonly used definition of an economic crisis, formulated by the American statistician Julius Shiskin in 1975, is formal: two trimesters of negative growth of the Gross Domestic Product. In the European Union, growth has dropped from an average of 2% in 2006 and 2007 to 0% in 2008 and -5% in 2009. Such a formal definition does not make however any reference to the performance of the financial sector so, at least in theory, we could witness a crisis in the real economy without a slowdown of the performance in the financial sector. But, in reality, that could rarely happen as the financial sector allocates a large part of the capital in the economy and performs the function of payments. There could be different indicators according to which observers could argue that there is a crisis in the financial sector. For example, the

European Commission argued that „there has been a general erosion of confidence in the past weeks within the banking sector. The pervasive uncertainty about the credit risk of individual financial institutions has dried up the market of interbank lending and has consequently made access to liquidity progressively more difficult for financial institutions across the board” (European Commission, 2008, p. 1). EURIBOR spread, considered a measurement of the confidence of the banking institutions in their counterparts, increased from less than 10 basis points to more than 170 so (the lack of) liquidity has been considered as the main indicator of the crisis in the banking sector.

In fact, the moment of the start of massive intervention of the member states in the financial sector is after the bankruptcy of Lehman Brothers in USA (September 2008), when the financial markets considered that similar events could also happen in Europe. That led to a halting of the interbank crediting.

The possible causes of the crisis

The quasi-totality of the European institutions dealing with economic governance in the European Union has correctly identified the symptoms of the financial crisis: the fall in confidence on the financial markets, lack of liquidity, mispricing of asset, problems in supervision, and wrong incentives in crediting and so on. Obviously, in order to advance an efficient solution for exiting a crisis, any policy-maker has to offer an interpretation related to the alleged causes of the phenomenon he attempts to deal with. Without disposing of such a causality relation, any attempt to take steps in the direction of solving the problems associated with the crisis may be futile. In order to administer a medicine, the health problem has to be assessed. A public intervention that wants to remedy an issue has to act on the core cause that generated the issue.

Maybe the most “theoretically-friendly” document endorsed by European institutions which offered an explanation to the causes of the phenomenon is the “Report of the High-Level Group on Financial Supervision in the EU”, chaired by Jacques de Larosiere and published in February 2009. As opposed to other papers, official positions and documents of the European Union, that usually are dealing with the “immediate causes”, this report took into consideration the broad economic framework that lead to such symptoms. It explicitly stated that „Ample liquidity and low interest rates have been the major underlying factor behind the present crisis, but financial innovation amplified and accelerated the consequences of excess liquidity and rapid credit expansion. Strong macro-economic growth since the mid-nineties gave an illusion that permanent and sustainable high levels of growth were not only possible, but likely” or that

„In turn, very low US interest rates helped create a widespread housing bubble” (Larosiére, 2009, p. 7).

The Larosiére Report fundamentally argued that the original cause of the crisis was the loose monetary policy adopted by the central banks both in USA and European Union. The most logical recommendation as a way of exiting the crisis should have been the return to a tight monetary policy (the control of the money supply) as well as the return of the interest rate to more conservative levels.

It cannot be but puzzling that among the 32 recommendations formally advanced by the Larosiére Group, none of them dealt in fact with monetary policy. The main explanation may be that the Larosiére Group was mainly focusing on financial regulation in the European Union and its ability to make recommendations of monetary policy was, as a consequence, extremely limited. But as the Report correctly assessed that the other factors derived in fact from the fundamental monetary factor, its solutions cannot be but partial and inconsistent when stopping short of this core factor. All such recommendations – such as review of Basel Rules, Credit Rating Agencies, accounting rules, securitized products and derivative markets, etc. – are just addressing some „immediate” or „derivative” factors. It could be argued that a state of the art financial regulation could not have prevented the emergence of the crisis as long as the monetary factors were the same.

The public policy reactions in the European Union dealing with the financial sector and related to the crisis can be broadly included in three broad categories:

- the first one is the monetary policies of the European Central Bank and the national central banks of the member states (like the Bank of England);
- the second one lies in changes in the regulation dealing with the financial sector;
- the third one lies in the state aid granted by the governments of the member states to the financial institutions.

Without analyzing too close the reaction in the monetary policy, it has to be pointed out that the reaction of the European Central Bank was to treat the crisis mainly as a liquidity crisis. In a systematic way, the European policy papers have highlighted this perspective, focusing on the fact that the large number of financial institutions were solvable (assets more valuable than liabilities) but that they were confronted with a liquidity problem. But this reality is a permanent fact of the fractional-reserve banking system. However, banks cannot avoid “bank run” situations of the deponents.

Starting with October 2008, the European Central Bank applied a “non-standard” monetary policy of “enhanced credit support” which translated into “unlimited central bank liquidity to eligible Euro Area financial institutions at the main refinancing rate and against adequate collateral” (European Commission, 2011, p. 20). Meanwhile, the main refinancing interest rate dramatically decreased with 350 basis points between October 2008 and May 2009 (ECB, 2010, p. 55). That is, after the start of the crisis, the core policy response was exactly the mechanism that the Larosiére Report argued that generated the crisis.

State aid control in the European Union

European Union is the only public authority in the world that enforces a regime of control of state aid associated with competition policy. Due to its particular nature of a political construction – both intergovernmental and supranational – European Union attempts to prevent a competitive subsidy race among its member states.

The legal framework for what is called state aid control is embodied in the Treaty of the European Union (TEU) which explicitly forbids what is called state aid: “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market” (TEU, art. 107). From this perspective, state aid to banks has drawn an important attention from the part of the European Commission, the guardian and the enforcer of TEU, which has frequently enforced the state intervention in the financial sector which was considered to significantly alter the competitive conditions.

Derived from the definition of the state aid presented above, any form of state aid is considered to have four core attributes:

- economic benefit/advantage = besides plain subsidies, competition policy in the European Union also qualifies as state aid an investment by the state in a private entity (including what is termed as “capitalization” or “recapitalization”) that does not observe the market investor principle (be done at market prices and be compensated with a market rate of return);
- transfer of state resources = which means that, besides resources from the state budget (any state subsidy qualifies for it), it includes also guarantees from the part of the state regarding the issue of new securities by a private actor and so on. While a guarantee does not

necessarily translated into a transfer of cash between the state and the private company, it may mean so in case of the default. So, all the schemes of guarantees qualify as state aid;

- selectivity of the aid = is interpreted in the sense that any state intervention that is dealing with all the private entities in the economy (such as a reduction of the income tax) cannot be qualified as distorting competition. While even such a position could be criticized from a theoretical perspective, it must be pointed out that industry – wide schemes qualify as state aid. While the financial sector has not been a particular attention from the part of competition authorities, a scheme that supply resources/guarantees to the entire financial sector qualifies as state aid;
- impact on intra-community trade = the aid must have a distortion effect on the natural flows of goods and factors of production on the Internal Market. For example, if a member state awards state aid to the entire banking industry, the banks which compete with the local banks will be negatively affected both on that particular market but also on other national markets in the European Union.

In other words, the subsidies that a member state may award to a particular company determine that such a producer benefit from an artificial advantage as compared to its competitors. In consequence, state aid supports artificial market structures that ultimately result in loss of consumer welfare. Moreover, the basic text of the state aid control in the European Union, which is the Treaty of the European Union, forbids not only state aid awarded to a particular company (that disadvantages the other producers in the same industry) but also subsidizing an entire industry. The reason for such a prohibition comes not from the wisdom that industry-level subsidies affect not only the welfare of that particular country (and other industries) but that such a public policy will favor domestic producers in their competition with other European producers from the same industry. In other words, industry-level subsidies in a member state of the European Union are a form of national protectionism that is incompatible with the Internal Market.

State aid in the financial sector during crisis

All the analysts, including the staff of the European Commission, qualify the degree and volume of state intervention during the crisis in the economy in general and in the banking industry in particular as formidable and novel as compared to the experience of the entire European integration. “The scale of the financial and economic crisis that broke out in the autumn of 2008, and the

systemic risks associated with it, were such that Member States used unprecedented amounts of State aid to the financial sector ... in order to restore financial stability and a normal functioning of financial markets, including EU companies' continued access to credit”.

In fact, the state aid pledged by the member states to the financial sector reached almost 30% of the Gross Domestic Product for 2008 (European Commission, 2010, p. 2). This is a huge amount which, taking into consideration the already existing proportion of the public sector into the GDP (more than 50%), would lead to an unprecedented presence of the state in the economies of the member countries of the European Union. However, the aid actually awarded between 2008 and 2011 didn't overpass 10% of GDP so the worst case scenario wasn't actually pursued.

The public policy reaction in the financial sector of the European Union confronted with the crisis has been embodied under several Communications issued by the European Commission. It is the case of:

- the Banking Communication = sets the broad principles that the state aid in the financial sector should observe;
- the Recapitalization Communication = attempts to reintroduce the market investor principle in the granting of the state aid by specifying the return that the state should obtain from the aid granted to financial institutions;
- the Impaired Assets Communication = described the mechanisms through which the state authorities should handle the core challenge of the “toxic assets” existing in the banking industry, the main threat to the balance sheet of these institutions;
- the Restructuring Communication = attempted, maybe too late, to tie the state aid to restructuring measures undertaken by banks.

In these policy papers, the European Commission attempts to aggregate the policy reactions of the member states in a European-level scheme that attempted to deal with the crisis. It was a huge effort to keep the logic of the state aid control in Europe and “legitimize” such massive interventions in the economy.

Why is the banking industry so special?

The qualification of the banking industry as a “special” sector in the economy is nowadays a common wisdom. Banks have the function of a maturity mismatch between short term liabilities (demand deposits towards the population) and longer term assets (loans awarded to businesses). Such a

maturity transformation leads to a higher liquidity risks for banks which is fundamentally attempted to be dealt with by central banking.

We won't explore in this paper the core debate in law and economics about the difference and relative merits between fractional-reserve banking and 100% reserve banking. It suffices to say that all the alleged characteristics of contemporary banking – its special character – come from the fractional-reserve banking system: “The social cost of a bank's bankruptcy is larger than its private cost, for three reasons. First, it affects uninformed depositors who do not have the incentives or the means to assess the risk they face. Second, the bank's knowledge of its customers, and especially of small corporations, is an asset that would be lost in a bankruptcy. Finally, the bankruptcy of one bank may generate a negative externality for all other banks through a contagion effect” (CEPR, 2010, p. 10).

The European Commission considered that “Banks firstly differ from ordinary firms in terms of the leverage of their business model, i.e. the share of debt in their funding compared to equity” (Larosiére, 2009, p. 25). Moreover, “markets in which banks operate are subject to systemic risk due to the massive negative externalities that a bank failure, or its anticipation, generates on competitors and the economy at large”. Such a systemic risk of contagion among the banking operators comes from the fractional-reserve banking and the core challenge for any bank operating in such a system to cover its illiquidity risk.

The impact of aid: the challenge of post-crisis rhetoric

Several economists have argued that the attempts of the European member states to intervene in order to exit the crisis have put the entire logic of the regime of state aid control under question. In consequence, the only reaction that the European Commission could have had, except giving up entirely to this regime, was to ease the limits put in the path of the action of these governments.

But such a conclusion is in fact in contradiction with the claim of the European Commission that the entire scheme was successful and that the anti-competitive impact was negligible. In other words, according to the Commission, there was only business as usual in the state aid regime during the crisis.

As some analysts argue, “the recently adopted State aid rules set a new balance between competition and financial stability” (Gebski, 2009, p. 89). But the term “stability” cannot be understood under the present conditions but as the conservation of most of pre-crisis market structures. In fact, the entire scheme avoided a punishment of the banks that undertook too much risk and built a balance sheet full of “impaired assets”. It has to be highlighted that these “toxic

assets” have not become so only after the eruption of the crisis. They weren’t toxic before only as long as extra-ordinary liquidity generated by the loose monetary policies and by ignorance of the basic measures of risk-management.

The qualification from the part of the European Commission of its stance during the financial crisis has been entirely optimistic: “state aid, with other policy responses, has been effective in reducing financial instability and avoiding a financial meltdown affecting the whole economy” or „state aid has contributed to restore confidence and stability in the financial system” (European Commission, 2011, p. 7).

The theoretical challenge of such conclusions leads to a bigger dilemma related to the nature of the economic systems: if state aid has been so successful during extra-ordinary period, why shouldn’t it be also successful during an ordinary period? Why reduce state aid after the calming of the financial markets? If there is no “positive aspect” that state aid didn’t accomplish during the crisis that it should not perform during normal period of time.

From such a perspective, a too optimistic evaluation of state aid effects in the European economy during the crisis leads in fact to a plea for the permanentization of state aid in the financial sector. And this cannot be translated but as a quasi-socialization of the banking sector.

Conclusions

The frustration of competition authorities that emerged during the crisis consisted in the awareness that they have to solve problems which have emerged in other areas of public policy such as monetary policy by the central banks or banking supervision by the financial regulators. This is a challenge for the competition approach as we may witness a banking sector which seems to be competitive (if someone looks at the market shares of the banks) but is oversized (because of monetary policy) and with poor protection of property rights (because of poor bank supervision). This is exactly the feeling of Ms. Neelie Kroes, the European competition commissioner, who declared in October 2009 that competition authorities were “doing the work that banking regulators should be doing”. Moreover, the idea that the banking sector is somehow insulated from the area of reach of competition policy is also under heavy fire as the same European Commissioner further commented that „this must be the last time that banks are allowed to create such kind of mess”. In a certain sense, central banks and banking supervisors have to pay attention to competition principles otherwise European Commission will intervene in cases that it feels that the rights of the consumers are broken.

The entire rhetoric of the state aid control during “normal” times has been under siege by the unprecedented amounts of state aid and its apparently “ad hoc” granting during the financial crisis. The attempt of the European Commission to save the state aid control regime is, after the crisis, under the fire of the opposite perspective: if state aid was so successful, why not universalize it in the banking sector. In other words, this could be also a plea for the socialization of the banking industry in the European Union.

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