

2007-2010 Financial and economic crisis nature

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Abstract. The causal structure of the present financial and economic crisis leads us to a revisiting of the economic cyclicality, especially concerning the temporal dimension of the economic cycle. In this end, the authors analyze the nature of the above mentioned crisis, from some point of views. As a result, some crucial directions of action are established as follows: the external channels of transmission of the crisis, the channels of transmission of the financial crisis into the economic crisis, the “optimal” order of the anti-crisis measures. Some possible adverse effects are pointed out in order to prevent any undesirable consequences of the governmental intervention against the crisis effects.

Key words: financial crisis, economic crisis, anti-crisis measures

1. Some milestones

The current international financial (and economic) crisis has some features that are important to be revealed, because from them depends on both understanding the nature and causes, and therefore the possible remedies to absorb¹ it.

a. Firstly, it is only a **financial** crisis. It emerged as a necessary result of excessive autonomization of nominal flows in relation to economic flows (i.e. excessive autonomization of the nominal economy in relation to the real economy). Thus, it was possible the emergence of so-called bubble in the nominal zone flows, which being not supported either explicitly or implicitly, by the real flows, exploded, resulting the recalibration of all economic and financial associated variables;

b. Secondly, it is a crisis with a **punctual** origin. It emerged in a certain part of the world (USA) and in relation to a particular area of business (bank loans);

c. Thirdly, it is a **cyclical** type of crisis. It follows the logic (at least as we know, until now, from the orthodox theories on economic ciclicity) of emerging, growing and declining logic of a done economic phenomenon, of an infrastructural nature, that become un anchor of the necessity to sudden recalibrate of the economic² system. In context, we think we have to face a crisis anchored in the logic of evolution of tandem nominal flows - real flows. Once this logic actualized, such a type of crisis emerged;

d. fourthly, it is a **structural** crisis. This feature results from the fact that not only certain relationships between the dynamics (and structure) of the nominal flows and the dynamics (and structure) of the real

¹ It is desirable that economic crises be absorbed, not... offsetted, because absorption means exploiting the opportunities that any crisis (not only the economic type or from the economic area) displays for those who are prepared, first culturally, to identify them.

² Metaphorically, the economic crisis, has in general, the same functions as a kind of geological earthquake: resetting up some coexistence and functional relationships

flows could triggered the crisis, but also certain relationships between the regulated financial activity and unregulated³ financial activity became potential causes of the crisis⁴;

e. fifthly, it is a *predictable* crisis. Predictability⁵ of the crisis that we are facing results, logically, both from its structural and cyclical nature;

f. Sixthly, it is an inherently *global* crisis. The globality of the crisis isn't an origin one (we saw that in this respect, it is unglobal, punctuated) but one of evolving, developing type. Given that, that is financial globality of the world (of financial flows – both counterpart flows and purely nominal flows) is on the first place of the globalization processes, the transmission, on a global scale, of the financial and economic crisis punctually arisen is just a time question and not of principle one.

2. Some suggestions for general strategy

Attributes of the current financial and international economic crisis, outlined above, lead, necessarily, to identify some suggestions for managing it. We would try to identify some such suggestions:

a. because it emerged from a punctual place, and because it has a global "destiny" (as suggested above), logically are occurring phenomena of transmission of the crisis in the world, namely the "geodesics" that describe international economic and financial relations. The intensity of these relationships is greater and the structure of self-sufficiency nominal flows in relation to the actual is more like (for example, by holding the so-called toxic financial assets), the speed and intensity of transfer of crisis are greater⁶;

-implication for economic policy: an initial reaction of the crisis management strategy should be the adjustment (because to obturate is not possible or desirable) of the channels of transmission of financial and economic crisis at the border economy⁷;

b. because this is a genuine crisis originated in the financial sphere (in the nominal economy), it is expected to pass it in the real economy, based on causal-functional interdependence between the nominal and real economy;

-implication for economic policy: a second response of the crisis management strategy is the adjustment (because to obturate is not possible or desirable) of the transmission channels of financial crisis in economic crisis⁸;

c. because it is a structural crisis, the crisis "objective" is to reset tensed structures in an un-tensed architecture. More specifically, it means about the necessity to maintain a functional coefficient of multiplication of the nominal flows value in relation to the real flows value⁹;

³ The regulation concerns the normative obligations including surveillance, reporting, insurance, etc.

⁴ A non structural crisis (that is, provisionally, phenomenological) is not caused by structural tensions but by superficial or accidental phenomena of economic activity.

⁵ In connection with this feature may appear (if they have not already occurred) speculations on the nature of the deliberate triggering of the current crisis in order to absorb, based on the rest of the world (see frenzy of loans granted or promised or suggested by the international financial bodies), the imputable costs.

⁶ Of course, here we can identify a "chain" of transmission (by linking of various homogeneous channels of transmission) depending on the intensity of economic financial and international relations, which could be quantified by the degree of economic openness (not only on real economy area, however, but also on nominal and financial economy area).

⁷ There are three channels homogeneous (standard) of "crossing" the border of the economy: a) real channels (external demand, labor migration, relocation of businesses), b) nominal channels (external financing, capital migration), c) institutional channels (treaties, agreements, institutional belonging).

⁸ There are five homogeneous (standard) channels for transmission of financial crisis in economic crisis: a) channel of bank credit (liquidity crisis), b) channel of commercial credit (arrears inter-firm trade), c) channel of tax (tax credits), d) psychological channel (decreased confidence, moral hazard, adverse selection), e) idiosyncratic channel (myopia, aversion to risk).

⁹ For reasons of economic behavior, this factor must be, necessarily, greater than 1. Threshold beyond which the numerical value of this coefficient becomes toxic is probably one of empirical but not of theoretical nature. However, even at the

-implication for economic policy: a third response of the crisis management strategy is to redesign the surveillance mechanisms of risk, the reporting and insurance/reinsurance mechanisms for financial and banking assets¹⁰;

d. because any crisis (and this is not an exception) constitutes an incentive for social innovation (managerial, institutional, behavioral, technological, financial, instrumental, etc.) that to lead not only to exit rapidly (and cheaper is possible ...) the crisis and to prevent or limit the risk of new crises, it is desirable to identify ways of gaining institutional run out of the crisis. Suspending of the opportunities, generated by the impact of the crisis, will cease for the first which see the "earth";

-implication for economic policy: a fourth response of the crisis management strategy is to finance the costs of rapid exit the crisis. This funding should be based at least on the following considerations:

- the state should pump urgent, massive and continuous liquidity in the economic system (particularly in the banking system), but attention, it is not an effective liquidity but a virtual one: State must restore confidence (particularly inside the circuits of bank financing such as inter-bank credit market), for instance by guaranties "production";
- financing a rapid exit the crisis should be done through government long term loans (5 or 10 years) in order to postpone payment of invoices related to loans after the crisis¹¹, because on the long term there are always solutions and resources, they lack only on short term;

e. because the current financial and economic crisis (both by its objective effect and, especially, the its psychological effect¹²) affects the whole economy and society ("promising" change of the mentality and even of the economic culture), economic policy solutions must have also in mind, the societal ensemble and, at the same time, must refer to the medium and, especially, long term;

- implication for economic policy: a fifth strategy of the crisis management strategy is to reduce, maximally is possible, the contractual nature (that is, the negotiation degree) of the fundamental strategies that the government implement in order to exit the crisis and / or to limit the adverse effects of the crisis¹³; that means integration, from a national perspective and for medium and long term, of the proposals, recommendations and supports coming from the social partners that, by the force of things, are sectoral, punctual and often addressed in the short term related.

3. Crisis Behavior

In justification of the economic behavior (or of an economic decision) the perception impact of an economic variable (as size or dynamics) is more important than economic variable itself. This makes that business may rather be the result of setting targets based on expectations than the result of an

empirical or intuitive (or based on experience) level, it could be maintained at a value that could be stimulative and functional (i.e. sustainable) as well. Maybe a Basel III, to formalize lessons from the current crisis in the area here discussed, should be an urgent goal.

¹⁰ As is known, at the European Union level, recently, Larosier Report refers specifically to this issue.

¹¹ Here is needed for a great caution because the domestic public borrowing can cause a lack of liquidity greater than the liquidity supply produced (effect of eviction of the private sector from the money market), therefore the act of the government to borrow from external sources could be appreciated to have a specific economic rationality.

¹² Because the economic behavior is guided rather by perceptions on economic variables size than the size itself of these variables, so the anticipations have a crucial role in putting the bases of microeconomic decisions, and therefore in the design of the economic behavior.

¹³ Public budgets, the anti-crisis program of economic convergence, etc.

objective dynamics of the "world economy". These considerations apply, of course, to this exceptional situation of the current financial and economic crisis.

In what follows, we want to point out some considerations, rather general, about what we mean by a crisis behavior. To not abstract too much the intervention, we will organize these considerations for the main social actors.

3.1 The crisis behavior of the government

We consider that the government must design the crisis conduct based on the following "principles":

a) *There is no crisis, there are countries in crisis*

Although can be elaborated logic models (even mathematical) of financial or economic crisis (logical modeling of the current crisis is still in the process of elaboration), the effects of an external crisis, as the current crisis is related to Romania, are specific. It may be said, in a metaphorical sense, that each national economy has its own... PH, which gives to the crisis its own "color". In other words, the anti-crisis program or strategy for Romania must to manage the crisis in Romania and not a generic crisis. This is why, for example, the program and the conditionalities imposed by IMF in the loan agreement recently finalized, should be adapted to "physiology" of the Romanian economy, otherwise it may cause adverse effects that can compromise even the best intentions.

b) *Every crisis contains potential of positive feedback*

The crisis logic (as an organic disease, in fact) is that to get fuel and to develop by itself. Therefore, a crisis contains self-catalytic capacities, that could accelerate it through the well known mechanism of the positive feed-backs. Unfortunately, we have too many analysts have passing with serenity from the analysis of a road crash to the analysis of causes and effects of financial and economic crises, and vice versa. This situation is likely to send catastrophic signals or apocalyptic expectations etc. to public. As we said in the introduction to this paper, is the perception that set the bases, in general, for the economic decisions and behaviors. In context, government officials must have a sober, responsible and realistic attitude regarding the dynamics of the crisis, the strategy and the management to administrate it.

c) *Anti-crisis program should not have political color*

Interest in a crisis management as "smooth" as possible is a national one, because all social (political) actors lose if the negative effects of the crisis are not limited. In this respect, the government must involve the whole society in the formulation, implementation and monitoring of national anti-crisis strategy. Justificatory reasoning is exactly the same that worked (more precisely, were needed to work) for the elaboration of the national post-accession Romania Strategy. At the same time, it must be reduced to the minimum possible the contractual nature of the elaboration of the national anti-crisis strategy, that meaning that the government must be formulator of the general philosophy of this strategy that follows to be proposed for public debate. Trying to develop an anti-crisis strategy as an anthology of the proposals of all social actors participating in public debate, could be a fatal mistake. Government must assume full responsibility for designing and implementing this strategy. Intention, which was recently crystallized in some political statements, that each political party must propose its own anti-crisis strategy, can be counter-productive, but more, may be downrightly harmful. In our opinion, the master document of the anti-crisis strategy must be proposed by the government. Overcoming the crisis is a social desideratum that does not allow ideological experiments, but only measures based solely on the logic of economic structural mechanisms.

d) *Anti-crisis measures must be placed in the strategy of immediate post-accession: joining the euro area*

Romania is engaged in a meta-national strategy: it is the strategy of accession to the euro area, at the horizon year 2014. It would be an error as anti-crisis strategy to be contradictory to this objective. In other words, it is mandatory that the whole philosophy of crisis management to be consistent with the philosophy of accession to the euro area. This means that short-term measures (aimed to absorb the immediate, i.e., manifest, effects of the crisis), must represent causal and / or conditional factors for

the medium term measures (to ensure nominal convergence of Romania with the EU at the horizon of 2012). So, this time, the master program of the government should be the nominal economic convergence (and, possibly, a closer real economic convergence), following that the anti-crisis program should be only a component, somewhat conjuncture, of it.

e) Anti-crisis measures must not export adverse effects to the EU

This condition can be extracted, in terms of logic, from the condition immediately preceding, but it is useful to be explicitly specified because, as a member of the European Union, Romania is in solidarity with the European crisis management strategy. As a result, not only that Romania must adopt those measures that are convergent and consistent with the measures taken in Member States or at Community level, but it must take care that by solving a specific problem at home, does not create negative externalities (spillovers) to other Member States or for the economic community as a whole.

f) Anti-crisis measures must be anti-cyclical

Ultimately, the crisis management mechanism is aimed to destroy the mechanism through that the initial "bubble" is transmitted by financial, economic, psychological, institutional etc. channels, to the entire economic body. This means, in terms of logic, reaching a "turning point" on the curve that describes the evolutionary trajectory of the crisis. Reaching this point means reversing the logic imposed by the crisis. In other words, the anti-crisis measures should work in reverse way in which acts the crisis, namely in an anti-cyclical direction. This is the reason for any increase in general consolidated budget deficit (of course, not to the level "forecasted" by the IMF) is not, in current conditions, a negative aspect, but if it will be well used (both financing and spending sides), by the contrary, it may be a lever to reverse the direction of the domestic economic activity. As we proposed about two years ago, Romania needs a law on fiscal responsibility, to ensure, among other things, specifically the anti-cyclical fiscal policy budget (it is interesting that the IMF delivered the same proposal to the government of Romania in the recent negotiations for concluding a loan agreement).

g) Anti-crisis measures must be coordinated

Government is expected to initiate and integrate the anti-crisis strategy, but it is not the only factor involved in crisis management. If the government fails to coordinate, in a synergetical way, all determining factors in this process, the chances of success of such an approach will critically decrease. Outside the government, that acts through the fiscal budgetary instrument, there are still four key institutional actors in the anti-crisis strategy:

- *economic research*: with its fundamental objective to identify and develop mechanisms and initiate self-control processes, of anti-cyclical nature, to underpin the financial economic and management innovation (including the governmental level), in a short and medium term; and in this respect, it's a serious mistake to reduce the funds allocated to financing research projects managed by NCSRUE¹⁴, that have been approved at funding in 2008, some of them even in advanced stages of design – it is forgot that funding research is the most profitable public investment;
- *central bank*: with the objective to adjust nominal flows in order to maintain the financial stability;
- *banking system*: with its fundamental objective to relaunch the non-governmental loan;
- *employer trade-unions*: with their fundamental objective of re-taking off the domestic supply (including crisis goods, services, and market).

h) Anti-crisis measures must not be disproportionate

Exaggerating the scale of anti-crisis measures (even if they are adequate) may cause similar harm as are caused by omission of anti-crisis measures. The symmetrical image of the impact of institutional response to crisis challenges must invite to consider the following elements in designing anti-crisis strategy:

¹⁴ National Council for Scientific Research in University Education.

- short-term objectives should have the potential, through their achievement, to turn into resources for achieving the objectives of the medium term;
- avoid that situation which, by the taken measures, could generate moral hazard or adverse selection of any kind;
- limiting the government intervention in the cases and at the dimensions of market failure in the outrunning of the crisis effects;
- avoid excessive contracting of domestic consumption (especially if it is related to the domestic supply), since there is a symmetry between production and consumption (not to forget an essential fact of the economic generic mechanism: ultimately - that is on long term but, in a certain extent, on the medium term as well- the target of economic activity is the final consumption not the investment, which is only a tool for the former).

i) The basic objective of the anti-crisis decision of government: re-taking off the economic growth

The only way through the negative effects of the crisis will be absorbed (i.e., transformed, to the extent possible, into opportunities) is re-taking off the economic growth by increasing domestic supply. The increase of the domestic absorption should be relied mainly on domestic supply (in fact, a decrease in imports will be involved in "automatic" way, by the decreasing in exports generated by decreasing of the external demand), of which fixed capital formation should hold the highest growth rate. Public budget deficit should be used to create the multipliers of GDP, with effect on the horizontal drive. Consumption may also be used in a smart way to help relaunch economic growth, as described in paragraph immediately preceding.

3.2 Crisis behavior of non-financial firm

In our opinion, non-financial firms should base their crisis behavior on the following "principles":

a. Dismissal skilled employees is a strategic error

Even if there is, for now, a decreasing in demand for consumption, non-financial firms should not hurry to lay off the qualified personnel. Transferring of the financial crisis in a persistent economic crisis (therefore having a structural nature) is unlikely, especially with the recent measures to ensure funding through an external public credit. The cost of conservation of qualified personnel is much lower than the cost of recovering staff in question after it was lost (for example, finding of a new job can increase the opportunity cost of employee fired). In addition, the higher is the dismissal, the higher is the loss of professional qualification, which can generate subsequent costs to recover the initial level of qualification (which is an effect of negative externality type, similar in nature and logic with the production environmental pollution, i.e., acquires a social nature).

b. The crisis goods, services, and markets represent a necessity

Crisis goods and services address the goods and services that reject the over-utility, keeping only those strictly necessary functions required by buyers who, by the force of things, have fewer resources to finance current consumption. Although - for example, in case of durable goods – rejecting of the over-utility will produce a decreasing in comfort, consumers will prefer to acquire only minimal functions of goods and services (which provide yet safe operation), giving up the features that are either unnecessary, or have a simple aesthetic or extra comfort significance.

In turn, crisis markets are defined as those markets that accept standards of relatively low quality, or face with a deficit of supply at this time or in a predictable one, as a result of the financial and economic crisis. These markets may be internal or external. In the case of foreign crisis markets, identifying and accessing them could offset the reduction in exports, as a result of the demand decline of the traditional market to which Romania exported during the previous period (with an impact not only on domestic supply growth - GDP - but also on reducing the external deficit of the country).

3.3 Crisis behavior of the banks

In our opinion, banks should base their crisis behavior on the following "principles":

a. Taking-over of a cost part of growth relaunching

The banking system (in fact, in general, the financial system) has a logic dependent on the logic of real economy. The current reticence of the banking system in Romania in granting of non-governmental loans is the result of an excess of caution (natural excess, of course, but that is not sustainable over the medium term) generated by the impact, rather psychological than objective, of the penetration of financial and economic crisis into Europe and Romania. As a result, banks cannot maintain, in relation to the real economy, an excessive autonomy in a medium term (and even less in the long run) without paying the cost of exit the market. Obviously, given this cost, the cost the banking system could pay to resume non-governmental lending is much smaller. In addition, the latter cost is largely covered by the interest of the real economy to resume growth. Therefore, economic rationality itself impose to the banking system to calculate and to take-over a certain risk (cost) while resuming of lending to the real economy (this could be, in fact, a *sui generis* investment that banks make through the non-governmental credit, or any investment involves a risk).

b. Focusing on three key lending

The banking system should focus on three type of non-governmental credit:

- loans for domestic direct investment;
- loans for pre-financing and co-financing of European funds absorption;
- loans for payment of outstanding budgetary obligations.

Of course, insofar as the effect of crowding out is not too high, banks should invest in government bonds on medium and long-term. If this effect is relatively large, then purchasing of government bonds on short term or very short term is desirable.

c. Avoidance of adverse effects arising from prudence

Immediate reaction of the commercial banks to the (real or imaginary) effects of the international financial and economic crisis has been growing of the prudentiality. This led to the decreasing of the trust (for instance, on the inter-bank market, but also in relation to non-governmental and non-banking customers) to turn into a *sui generis* crisis of liquidity. Operation in these conditions leads to the stagnation of the non-governmental lending (both banking and non-banking) exclusively by the prudential reasons, which are subjective reasons based on hypertrophic expectations and predictions. Such behavior can compromise (or decisively diminish) the chances of retaking-off of real economy growth. But the gap between the offer of the real economy and money covered necessities for goods and services may have adverse effects even on the nominal economy (inflation, exchange rate, interest bank rate). Para-phrasing Sartre, the nominal economy and real economy are condemned to live or die together. The current international crisis is nothing, for example, than the "divorce" between the nominal economy (which was considered able to run itself own) and the real economy.