The Issue of the Financial Regulations and the Crisis – Romanian Case

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Abstract. The harmful effects, on medium and long term, the financial crisis manifests on the economy, requires a deep analysis on the specific phenomena, aiming to the diminishing or even the eliminating of the unwanted effects. This way, an effective operation, asks for a correct diagnosis over the phenomena which implies the precise identification of the generating factors. In the end, action has to be taken on the identified factors generating financial crisis. The present work, makes an analysis of the real causes that lead to the financial crisis in Romania, considering the global context. It is this global context in which there have been identified some answers to the crisis problem.

Keywords: risk management, financial stability, credit institutions, financial crisis, regulation.

JEL Codes: G01, G21.

1. Introduction

The analysis of the financial crisis that has spread globally, including Romania, brought to tough debates regarding the causes that triggered the crisis, globally as well as nationally.

The identification of the triggering causes of the financial crisis represents only a part of the problem. What is more important, in our opinion, is the identification of the best answers to get out of the financial crisis situation. Obviously, the identification of the best answers is inevitably connected to the correct diagnosis of the “disease” that the economy “suffers from”, respectively, the identification of the real causes.

There are many causes that brought forward the crisis situation, some of them carrying some sort of specific given by the particularities of an economy. In the debates on the factors that trigger financial crisis, there has always been a common point of view: the proportion between the free market and the public authority, namely, deregulation vs regulation.

From this perspective, there are two main doctrinal trends; on one way, the supporters of the interventionism sustain that this crisis is caused by the failure of the free markets, consequently, the way out of the crisis is given by the public authorities intervention, namely, the regulation. On the other hand, the liberalism supporters consider that the excessive regulation or the regulations inefficiency represent the main reason of the present financial crisis state. In this case, the best solution can be given by the diminution of the state’s role, consolidation of the free markets, namely, the deregulation.

Considering the above, the regulation issue has to be taken very seriously as the governing body that watches and controls the activities performed by the private institutions. The main objective is efficiency, correctness and safety. In the same way, the deregulation has to be understood not as a renouncement to regulations but as an encouragement of the initiative and of the freedom of the economic agents by decreasing the control of the public authorities and, implicitly, a taking over of the responsibilities regarding the risks control at microeconomic level.

Taking into account the fact that this economic crisis emerged from the USA (the subprime crisis), it is obvious to see that all the attention has to be focused on the financial regulations area; more exactly, this represents the state intervention in the economy, in an indirect way, through the financial regulations.

The state has to consider two objectives: a tactical one – risk control and a strategic one – the crisis avoidance. The crisis avoidance or the diminishing of its effects represents an objective that falls into the final strategic objective the sustainable economic development.

The objective of any economic activity is the economic growth/ economic development, but, since any human activity takes place under uncertain conditions, the economic initiative implies the risk taking (Nicolae Danila 2010) that has to be evaluated and, in this case, the banking system plays a major role in the proper reallocation of the present resources.
The turning out the crisis or, the avoidance of the supposed future crisis, is based on the best risk management strategies in any activity performed as well as a banking system, capable to ensure all the necessary resources to launch the economic growth. Even though the economic crisis happened because of some mismanaged situations in the financial system (at the global level), the diminution of the economic uncertainties cannot be achieved just by one part of the economic system. The economy cannot grow only by the consolidation of the financial regulations.

The determinant role in achieving the decreasing of the economic uncertainties objective is played by the mix of economic policies (Danila 2010). This big role can be played by the public authority that is able to promote and manage coherent economic policies at the level of the whole economic system.

2. The causes of the Romanian crisis and not only –the excessive regulation or the deregulation?

The economic crisis that Romania goes through, cannot be taken out of the global context. Even the Romanian context that credits the idea that the economic crisis would have happened any way in Romania, (Liviu Voinea, 2010), there are some external factors that brought forward the crisis, that can be considered triggering factors of the economic crisis in Romania.

To better understand the real causes of the crisis in Romania, it is necessary to make a presentation of the factors that stood at the basis of the world financial crisis and, in this way, there is a series of opinions that lead to two opposing points.

On one way, there are opinions that show that the triggering causes come from the deregulation of the financial crisis and, consequently, the suggested ideas to bring to the economic growth are preponderantly based on the public authorities’ intervention and, on the other hand, there are opinions that show that the crisis comes from the excessive regulation, and, in this case, they suggest the consolidation of the free markets.

The main reason that brought to the crisis in the USA and extended globally, is the liquidity excess. Since 2001, FED has lead to a policy of counteracting of the speculative balloons which were present on certain markets (the real estate market, the dot coms markets) by the cutting down the monetary policy interest rate.

The present liquidity excess existing on the market stimulated the investors to innovate, to figure out alternative solutions in placng the excessive funds, all these actions bringing to excessive financial investments. The financialization of the global economy, is considered by Watt (2008) as the main reason of the crisis, this is because of some managers' orientation towards activities that generate high profits on short terms.

The new financial instruments, which are necessary in the context presented above, have permitted the investors to better administrate their portfolios in a volatile context (Ovidiu Stoica 2006). This didn’t come without effects due to the fact that the innovation led to more and more complex financial products through which the investors took more and more risks and which combined with the lack of transparency made it much more difficult to understand and quantify the risks.

In this respect another fundamental cause in the generation of the crisis appears- the massive undervaluation of the risk- fact which was underlined during the evolution of the crises, (Danila, Nicolae 2010).

The financial innovation produced in the context of a deregulation process, process which was visible since the 1980’s (Ovidiu Stoica 2006) and which was characteristic to the entire society but with a larger presence in the economic-financial system especially in the developed countries. The deregulation process from the last decades didn’t necessarily mean the renunciation to regulations but the simple presence of some areas and/or financial products less “controlled” and less transparent combined with strong innovation led to the accumulation of risks in the financial system.

There are also opinions on which the accelerate increase in volume of the complex financial instruments in use and implicit the acceleration of the innovation is the result of excessive regulation. In this respect to the public authority’s actions of activity regulation (Basel I and Basel II Agreements) the commercial banks answered with taking out from their balance the high risk actives utilizing this very innovation (Bogdan Glavan, 2010). More than that, the excessive regulation and transparency blocks the entrepreneurial capacity of the banks to select the investment projects accordingly with their own policy being forced to an standardized behavior, “the herd like” behavior.

Even if we can’t identify a direct link between the existence of a regulated or excessively regulated market and the accumulation of risks in the system, still the effectiveness of regulations can be questioned.
It is a fact that a regulation can have deficiencies even from its birth. The regulated activity being a very complex and dynamic one it is practically impossible to have the reality in a model no matter how complex this is at its elaboration. But even though we admit that the initial deficiencies can be neglected (the impact is not important) still the activity dynamic alone is enough so that the model (regulation) to inevitably become obsolete.

In this respect we can identify another cause responsible for triggering the crisis: the falling behind of the regulating authorities (Croitoru Lucian 2010) and/or the weak efficacy of the financial regulations (Silviu Cerna 2010).

According to Nicolae Danila (2010) and Silviu Cerna (2010) the specificity of the nowadays crisis is strongly tied up by the model-respectively-by the way the active evaluation, the risk analysis and the decision making is done.

No matter how complex a risk evaluation model would be in the end it still represents a simplification of reality so that the obtained results can not contain the reality entirely. A commercial bank can not evaluate all its investment projects using statistics models even though they fall under the same category of operations, without taking into account the risk of some errors which finally, will materialize into potentially accumulated risks.

Coming back to the Romanian economy some characteristics of the evolution show that the start of the crisis was inevitable and the start of the global crisis was a triggering factor and had a significant influence on the characteristics of the Romanian crisis, and I refer here at aspects related with the timing, the amplitude of the events, revival, etc.

The excessive monetary liquidity at the global level had no other effect than to influence the financial banking system and the economy in general. The pressure applied from the inside by the abundance of liquidities was stimulated by the high interests of the Romanian banks (the result of inflation) and by the development of the banking system, especially after the year 2006 since Romania enter the EU, fact that offered the investors new opportunities for further investments. At the same time, the capital account was liberalized, which led to the increased pressure, already existent on the market.

This resulted in the accelerated growing of the financial intermediary services from a percentage of 21,84 % in 2005 to 42,73 % in 2008. The non governmental credit has risen spectacularly, yet, on the background of a modest saving on the local plan, they registered major unbalances at the credit structure level, especially on the population segment. Thus, by the end of the year 2008, this was the structure: according to the destination 74% represented the consumer credit, according to the maturity – 82% represented the credits on the long term, according to the currency – 58 % represented the credits in foreign currency (according to NBR).

As it can be seen from the National Bank reports, the population ran into debts mainly for the consumer goods on the longest terms possible, simultaneously with a big growth of the debts in the foreign currencies (which exceeded the exposal in lei). This phenomena had a great impact on the external balance leading to the growing of the deficit of the current account.

The internal request has been stimulated both by loaning policies as well as by cyclic budgetary policies, which has brought to massive imports that has as result the aggravation of the external balance.

Therefore, there is a certain aspect specific to the Romanian financial crisis, generated by an unbalanced economy from the structure point of view, however, on the background, the financial problems are similar with the international ones: excessive liquidity and the underestimation of the assumed risk. Considering the assumed risk, even though, there hasn’t been made use of complex financial instruments, the underestimation of the risk is obvious, when looking at the evolution of the overdue and ambiguous credits during the time following the crisis. (Nicolae, Danila 2010)

3. Solutions to the issue of the economic crisis

There is a single solutions to solve the issue of the financial crisis: the economic growth. Every economist agrees on this matter. However, as there are many factors that brought to the economic crisis, the same happens when it comes to reconsider the economic growth. There are many ways to do that and many solutions to solve the matter. One of the crisis reason is the overtaking of the weak efficiency of the regulations – it is a complex problem and it is also very difficult to solve because, if the risk that comes with every economic initiative can be known as a probability of the uncertainties (Nicolae Danila, 2010), the uncertainty in which the human activity performs, is unknown. (Silviu Cerna, 2010)

Moreover, accepting that the risk can be measured and shaped making use of the best instruments of the contemporary economic science, as it has been shown, any model represents a simplification of the reality and if the cognitive value of the models cannot be questionable, the precision and the reliability of the results are questionable. (Silviu Cerna 2010)
Given the circumstances, the problem to be solved is the reduction of the economic uncertainties and the best way is, as shown in the introduction, the mix of economic policies. Reaching the final goal of economic growth can be achieved through a "cooperation" at the optimum level of the different policies involved in the mix (monetary, fiscal, structural, etc). Any deviation from the best level of functioning of any policy, affects the result of the whole mix because no policy can achieve the final goal by itself. In this direction, the usage of the mix of policies is suggested by Voinea (2010). He says that the healthiest economic growth can be achieved by growing the number of work force.

The mix of policies suggested to increase the work force occupancy, includes activities in the banking system (access to obtaining financial loans), but also in economy on the larger scale (public investments, taxes adjustment, increasing the number of grants offer etc). All these activities belong to the interventionism current, therefore, it is about the regulations included in the accepted definition.(Bannock, G; Manser, W, 1990).

The suggested solution, respectively, the increase of the work force occupancy, is a a very convenient one in the context of the Romanian crisis and of the actions taken by our entrepreneurs in order to reorganize their own businesses. Ever since the beginning of the crisis, the most visible measure taken (in most cases, the only one) and which stays as a leit motif of the actions taken in the private system, the employees' dismissal or the salaries adjustment. This measure, considered necessary in the context of request reduction, can not be the best method for the business reorganizing, in other words, it is not enough and it does not prove remarkable managerial skills. The measure mentioned above is included in the category of defensive measure of a business reorganization (according to Meyer, 1998).

Nicolae Danila(2010) proposes a mix of policies as well, but, this time, he aims the financial area. The policies have to ensure the diminishing of the uncertainty by taking actions on two directions: commercial banks, on one way and the central bank, on the other way. The uncertainty reduction has to be achieved starting with the keeping to the freedom of movement of the economic entities, therefore they need to stimulate the freedom of the financial markets. The requested change involves the free acceptance of a new model of doing business which could be less riskful for the banks. The risk underestimation was certain in the former period of time and the Romanian banks have to activate in order to decrease the risk by consolidating the traditional activities, targeting more on having a longer relation with the clients and less on obtaining profit on short term. (investment banking). The banks play a major role in the following period of time, considering they are the entities that own the resources necessary for a free market, they also have the qualified capacity to asses the risks, the business opportunities and the future directions of development.

The economic revival cannot be achieved without the revival of the banking activity and the banking activity has to rely on " the long perspective of the banker, in which the essential fact is the relation with the client, not the momentary profit" (Nicolae Danila 2010) The second direction comes from the central bank, whose role played in the financial stability has to grow significantly. The role played by the financial stability is essential both, in the financial system as well as in the economy, and the importance of the role played stood out in the context of some economic conditions afflicted by financial turbulences and / or by the financial crisis. The globalization and the economic development involves the growing of the financial institutions as well as their area of activity, a greater number of entities that activate both nationally and internationally, on one or more continents, has brought to the increasing need of financial stability at the global level.

Under these circumstances, here comes the question: what is the best road to take in order to ensure financial stability, and the answer gets shape from two different approaches. On one way, it is the regulation, understood as the supervision and control of the governing institutions on the private institutions in order to ensure the most efficient, correct and safe activities performed by the private institutions, and, on the other way, it is the deregulation, understood not as a renouncement to regulations but as an encouragement of the initiative and the freedom of the economic agents, implicitly, an assumption of the responsibilities regarding the risk control, at microeconomic level. In consequence, the same objective, financial stability, ensured on one way starting from the macroeconomic to the microeconomic (regulation), and on the other way, starting from microeconomic to the macroeconomic (deregulation), two different visions that can not be totally separated, letting a shher line between them which is continuously moving and intermingling.

This idea which is to be put into practice can be recognized among the actual European principles that stand at the basis of the financial stability and which consist into two defencing lines:

*The first line*: the banks with responsibilities at microeconomic level;
- maintaining solvability;
- managing the assumed risks;

*The second line*: the public authorities with responsibilities at macroeconomic level.
crisis prevention and minimizing through regulation and prudential supervision;

The financial crisis and the risks persistence show the “necessity of a proactive attitude from the government side and of the central bank” (Nicolae Danila 2010) in order to ensure a solid financial system and a sustainable and a constant economic growth.

In the same time, it cannot be forgotten the regulations limits (the crisis spread during the implementation of the Basel II Agreement) also the fact that one inadequate regulation can accentuate the financial instability. (Silviu, Cerna 2010). Ensuring the proper balance between the markets freedom and the regulations (Croitoru 2010) has to be a permanent objective and any exaggeration in one way or another can be harmful.

When making new institutions or new regulations, the limits acceptance has to be a detail to carefully consider, namely, the limits acceptance of any systems of risks management (no matter complex they can be) and pay great attention to the human factor.

4. Conclusions

The durable economic growth is and it has to remain the strategic objective of any economic activity. Reaching this objective involves a long term vision, focused on a coherent mix of economic policies, in which the human factor plays a determinant role. The causes of a financial crisis can be various, and usually, they are caused by the deviation from one of the economic policies promoted and, under these circumstances, resetting the balance can be the solution to the crisis counteracting or the diminishing of their effects. The balance and the coherence of the economic policies, absolutely necessary reaching the long term objectives, have to stand on the human capital development and improvement, reconsidering the importance of this great factor and not only on the strong idea that, no matter how effective and very well constructed one could be, one of the economic policies can not substitute the non existence or the inefficiency of the others.

References: