CLOSE RELATIONS ON THE FINANCIAL MARKETS AND IRREDUCIBLE UNSTABLE ECONOMIC PERFORMANCES

Mădălina Antoaneta RĂDOI[*]

Alexandru OLTEANU[*]

Abstract

The evolution of the market development of any kind registered an overlapping and conditioning of financial markets and economic performances, reinforcing, after the 80's, the connections between the financial system and industrial economy in relation to the age of conglomerates. Although the financial system uses its assumed functions of not being responsible for the cyclic instability of the economies, which has a negative influence over the average rate of economic growth over long periods, macroeconomic analyses reflect the financial origins of cyclic instability.

Keywords: *Neoclassical financial market, neoclassical general equilibrium model, basic Walrasian model, strong-form and semi-strong financial market efficiency, capital markets general equilibrium model, marginal efficiency of capital.*

Introduction

The functioning of the markets is mainly based on two models, the "Neoclassical general equilibrium model" and the "Basic Walrasian model".

The neoclassical general equilibrium model comprises the general equilibrium properties of commodities markets and capital goods and of financial markets. Within these we find the same form: the atomicity of supply and demand, homogeneity of products, transparency of exchanges, and mobility of financial resources. In a perfect competition, the free allocation of capital allows continuously raising their economic performances at an optimal level.

The basic Walrasian model has multiple characteristics: economic and financial decisions are made by rational individuals who are perfectly informed regarding market conditions at any given moment; the markets have monopoly over the aggregation and alignment of supply and demand; the so-called pure and perfect "competition" excludes all forms of power over prices; the equilibrium prices are a result of anonymous forces.

The model brings a response to one of the problems that continue to be asked for over a century. It incites to an approach based on the specificity of the nature of the relations between the financial market and economic performances, taken as a whole.

[*] Lecturer, Economic Sciences Faculty, "Nicolae Titulescu" University, Bucharest, radoimadalina@univnt.ro

[*] Professor, Economic Sciences Faculty, "Nicolae Titulescu" University, Bucharest (e-mail: aolteanu@univnt.ro)

Literature Review

• I. Relations still limited by mediators

The neoclassical financial market organises the meeting between the agents holding financial capacities and the agents needing financing. Manufacturers, sellers of commodities, are not in the position to self-finance 100% of their equipment expenses. They can manage the placement of their available capitals in addition to supply. In this model, the supply of capital meets the corresponding demand without financial mediators. The equilibrium of all the economies supplied by the capital and investments market, with no losses, is reached with nil mediation costs. The market may differentiate what equilibriums are possible.

Keynes' general theory marked a rupture with the unifying visions summarised by the markets' general equilibrium. Therefore, two sides of the market are very different. Businesses and individuals are not in the symmetrical relation adopted by Walras for the representation of the supply and demand addressed to markets of commodities and factors.

The capital market works in accordance with all modalities that make this difference as imaginable neoclassical models. Wicksell highlighted, against the orthodoxy of his age, the role of banks within the credit market: distinguishing between the natural rate of interest and the monetary rate required by the banks, which prefigures the Keynesian developments of the marginal effectiveness of capital and the use, which is of interest to this day, of the rate of return on equities.

The capital's rate of interest includes the variable risks premiums in accordance with the debtors' quality. The aversion to risk incites to prudence and abstention; under the form of distrusting the volume of exchanges, and the judgment used in obtaining credits and the miracle of capital operations make the economy to be one of under-investment, if the neoclassical model is taken as a reference standard.

The imperfections of the market information open with the Malthusian practices, which keep in check the increases and degradations that are of no use.[1]

The global role of banks and, at a broader level, of the financial mediations ensemble, is a positive one in regards to adjusting the capital supply and demand.[2] Regarding the term of "financial system", it also includes the capital market.

A system in which specialised organisations, banks and other mediators facilitate the movement and distribution of capitals links these two activities. Generally, the management of primary economies consists of entrusting their liquidities to an ensemble of financial institutions that act as institutional investors: pension funds, mutual funds and SICAV, speculative funds, insurers, private equity funds, real estate participants' guarantors, etc.

Banks remain the main source of external funds for enterprises. **Or, banks act in a double risk universe**. On one hand, as all enterprises, the bank is subject to the constraints of financial equilibrium; they are concerned with winning parts of the profitable markets; they compete and cooperate with the syndicates on competitive markets; they consider shareholders: they fully participate in mergers, acquisitions and other restructurings.[3] As such, they diversify their activities (credits, deposits, enterprises reconciliations, financial arrangements, wealth management, etc.), and differentiate their products and services for a better capitalisation of their distinctive advantages. The monetary market introduces new financial instruments; alternative

[1] Akerlof, Spence, Stiglitz

[2] Gurley & Shark

[3] Bienayme, 1998

financing procedures allow large enterprises to depend less on credit institutions for their cash needs. For the large clients' services segment, banks exploit their compared advantages. The specific advantage of a bank in relation to other financial mediators is providing two services instead of one: underwriting and procuring payments instruments which, in excellence, are the currency, and that which offers credits, guarantees and other derivatives. These activities generate together synergies that reduce the estimation costs of credit risk, since the history of a deposit account informs a banker about the financial position of the depositing client. The bank is also a coalition of creditors that diversifies the credit risks. Depending of their market share, enterprises accept debt after the banks have an inferior rate of interest to the market price because the bank sees the confidential information it holds, signalling their high quality market; this confidential signal allows the entity to supplement its financing sources by addressing the market. On the other hand, banks encourage specific types of risks, such as the credit risk and the liquidity risk.

The relation of the bank with its client evolves constantly depending on the business climate and its solvability.

The activities with banks should be accompanied by a high service quality bringing returns for the banks, but not through suspicious loans: the deposits' liquidity should be guaranteed; the increase of credit risks and operational risks should be competently overseen; clients should have the capacity to measure to an extent the loyalty for supporting the bank in case of difficulties. In case of bankruptcy, a banker strongly affects his clients. Maintaining a reduced competition on the credit market functions soundly only when the probability of debtors' weakness remains within tolerable limits.

Foreign currencies, loans and reimbursements on the capital market are a collective commodity: they are not accepted solely for the simple fact of being liberated, to answer to the wording Keynes used to summarize the neoclassical model.[4] The value of the currency dominates the relations between creditors and debtors. The Central Bank arbitrates in this manner between its role as a lender of last resort and its mission as "master of inflation"; this implies that, in the position of "master", it would increase the monetary mass and oversee the quality of the credits granted in the economy.[5]

To summarize, banking and financial mediations have multiple particularities. There are various activities that allow, at a global level, the reduction of the uncertainty of deponents, of those who make primary economies and of investors of all kinds.

The multiplication of financial products and of securitisation possibilities for a resale on the financial markets ultimately allows the adjustment of market supply and demand. Financial mediations aggregate the multiple small economies, and diversify and mutualise risks. At the same time, they have functions which, if used competently and honestly, favour economic efficiency, at a general level, stimulate growth and the use of workforce.

Certain financial mediation activities generate operation costs. They are a consequence of the fact that primary economies are not wholly transformed into productive investments through lenders. They cannot generate a loss that would result in a lack of earnings for the national economy in relation to the neoclassical optimal level, since financial mediations are not attributed with a lack of earnings in real cases related to uncertainties, information asymmetries and countless moral hazard manifestations in business relations.

[4] Skidelssky

[5] Allen & Santomero

The financial market is congenitally opaque because of the simple fact that changeable assets are carriers of eminently random future return promises. Financial mediators, holders of primary economies bring a higher security and the trust they inspire in attracting capital without which there may be no contribution to production development.

There are countries where the financial services activity (necessary and of national magnitude) occupies a significant part in relation to GDP generating activities.

Financial mediators raise problems within the national economies because the neoclassical model does not have the necessary vocation to deal with them. This pure economy model sets aside space: it explores the economic logic of work within a world without borders. The insertion of national economies within the world dynamics highlights these problems. Our world, fragmented between over 200 nations of unequal powers, recirculates half a dozen key statements in order to facilitate the international transactions ensemble. Combinations between flexible foreign exchange rates and the free movement of information made the financial system strongly interconnected at a global level, being integrated starting form the end of the 19th century. National economies conserve financing circuits that are not indirectly integrated within the global system. Within the EU, which is more familiar to a system adopted in the 19th century, assumed finances decisively participate to the market economy.

After the end of the 1970's, institutional investors entered the capital markets and gathered the power of the arbitrages recently held by the financial directors of conglomerates.[6] Industrial enterprises were borrowed in order to achieve their mission of producing goods and services, of invoking procedures and products and of ensuring their positions as leaders on their markets. M. Pineau Valencienne counted in 1980 approximately 450 segments of globalised markets (type bluejean, rover). They reached over 10,000 today, and will reach 20,000 in the near future.

The capital market tends to assume its quotations in financial matters and proposes instruments adapted to the infinite varieties of partner needs: derivative products, asset swaps, financial volumes, etc. At the same time, the financial market has included industrial enterprises that wish to change their management criteria, without forgetting the theory regarding the election of activity portfolios from stock exchanges (that reveals an insurance diversification behaviour) in order to re-centre the activities in which the enterprises are more competitive (core businesses) in a manner that allows the capital market to run its activity, judge more investments and allow industrial enterprises to fathom their penetration on international markets.

This separation of activities is present through international investors as a guarantee of a higher transparency over a real profitability of productive investments from the so-called real area.

Finances are also attractive through the rate of return of equity funds (ROE: Return on Equity) which remunerates the enterprise's risk and its shareholders. ROE perspectives direct equity funds towards productive investments developed and operated by the enterprises judged as being the most effective.

Economic games are iterative, the investors carefully observing the results achieved by the enterprises. They develop the assumptions of a long series of successes, given with more talent rather than hazard; they assume that in relation to the market signals, enterprises have a certain chance to be encouraged in their projects to make other more efficient judgements.[7]

[6] Fligstein, Betbeze

[7] J.P. Betbeze

This evolution, begun in the 1980's, reinforced the links between the financial system and industrial economy in relation to the age of conglomerates. Macroeconomic analysis highlighted the financial origins of cyclic instability. It emphasizes the attraction relations between profits, investor anticipations, and equipment and credit expenses.[8] The increase of stock exchange rates creates a euphoric climate, facilitating loans. However, enterprises indebtedness increases risk. Investments multiply in a reasonable manner, also as a result of the credits offered by a good market, and banks share the investors' optimism. Or, just as in Ricardo's rationale regarding the most fertile lands cultivated, enterprises start choosing more investment projects.

In the expansion contraction phase, the phenomena reverse the game. However, decreasing the percentage of used workforce and decelerating salary quotas limits the fall of benefits. And, once the concerns regarding the revival of inflation are calmed, banks may be delighted to play a part against cyclicality.

Recent activities show a diversification of the mediums through which the "financial and monetary sector" influences the evolution and maintenance of the return to cyclicality.[9] The strictly monetary perspective acts as an advisor for the Central Bank for the width of the directing rate of interest, the volume of the mandatory reserves and the allotment of retirement effects. But, if an interest rate decrease encourages credit demand and increases the monetary mass, it will shrink on the longer term, to the extent in which the reimbursements volume exceeds that of new loans, which may delay a renewal of credits in the initial volume.

Contemporary theory emphasises the respective roles of direct finances (public directly paid in shares and bonds issues) and intermediate funding: bank credits, infusions from other financial institutions, funds management.[10] Exigent remuneration includes a premium increased for reasons directly related to risk. The rate of indebtedness of capital requesters is an indicator signalling risk.[11]

Mediation allows financing more complex industrial operations, brings tolerance for information asymmetries that influence the long financial information control chain.[12]

II. Economic performances are partially disconnected from the financial market

The facts resulted from the last unfolded period call for four sets of reflections regarding: the respective stimulation devices of business leaders, the financial market efficiency, the weaknesses of financial information control bodies, and business valuation. They lead to a prediction of a maximum of efforts directed to improving operations transparency, but the limits of these efforts are not emphasised.

a) The relation between the agent uniting leaders and external shareholders is as relaxed as the participation of the first capitals in the enterprise, which is limited proportionately with the equity funds as their personal wealth. Or, the leaders hold privileged information that grants an advantage over the shareholders and administrators it represents. This situation is favourable to conflicts of interest with the shareholders, who are, at the same time, those who save up, concerned with receiving their dividends and, as much as the owners, ultimately bear the residual receivable risk. Through the stock exchange, shareholders offer a way out through the liquidity of their securities.

[8] Zarnorvitz
[9] Barjou
[10] Boutilier & others
[11] F. Barjou 2000
[12] J.P. Pollin et Euronex, 2002

The idea stimulated leaders, who mostly take into account the shareholders interests, to use the share options method, which appears to have logical substance. Also, when options are correlated with the high advantageous prices of the last year, they contribute to certain increases of the number of shares and to a decrease of benefits to the disadvantage of external shareholders.

At the same time, a partial consideration of the problems raised by the share options distribution, entry price, and conservation expenses results in the alignment of the leaders' interest research over shareholders not being automatically correlated with the enterprises' conduct over the long term. The continuous research of the enterprise's maximum value for its shareholders may prejudice the adoption of projects more favourable towards competition over the medium and long terms.

(b) Second, an economy that complies with the canons of the neoclassical model reaches efficiency. A more realistic and dynamic approach to economic performances and financial market transparency leads to distinguishing multiple efficiency decreases over the last period. In adopting the point of view of securities buyers and sellers, the financial market is efficient if it allows balancing their portfolios, even the more as this is in their own interest.[13]

E. Fama (1961, 1970, 1991) analysed three decreases of efficiency, in accordance with the available type of information. He distinguishes a weaker variety, in which the information historically reduces the stock exchange rate, a semi-strong where the information cover all of the published data susceptible to influence the enterprise's value (balance sheet, accounts, PER, circumstances, etc,), and a strong form that includes privileged information only accessible to initiates.[14]

In accordance with the strong efficiency hypothesis, agents operate on the financial market while holding perfect information; this public information, in its entirety, comprises the price of the shares synthesised by current and present stages. Agents can also measure each security's expected profitability and risk. No one can estimate the sustainability of a superior market performance. Optimist economies affect their time crossing resources and provide the enterprises with the funds they need to invest. Strong efficiency defines the market's condition when all the possibilities to make mutually advantageous transactions are exhausted. At the limit, transactions stop and the market becomes inactive in the moment it becomes absolutely efficient. The volume of the transactions observed on this type of efficient financial market is limited to the quasi-instantaneous observation of new opportunities for advantageous investments.

This school case homogeneously deals with both capital and goods markets. Fama considers the financial market efficiency a necessary condition for the optimum in economy, the so-called "competition". This market achieves an optimal allocation of capitals and equal securities transactions without delays of profit rates in different activity sectors. The rationale of the description of properties in a pure market economy makes transactions insure by themselves the coordination of economic activities. If such an economy exists, the price mechanism is sufficient to guide the entrepreneurs' saving decisions.

Or, an economy of this type ignores the enterprises, their particular solidity, their singularities and their market capacities. Enterprises with interdiction shall generate by their presence the compliance with the efficiency conditions of the financial market. Convergence between the market efficiency and the economic optimum disappears when perfect competitive conditions are

[13] Fama E (1961, 1970, 1991)

[14] Jacquillat et Solnik

missing. This is the case of reasons concerning the capital demand, issued by large listed companies.

The notion of available information is ambiguous. In our world, leaders inevitably hold private information and tacit knowledge which procure perspicacity to the market. They decide according to detailed technical, commercial information and financial reasons. The enterprise which sells its shares on the market, for example, in order to increase its capital, does not act as a simple securities seller.

Strong efficiency does not recognize the continuity solution which separates enterprises with results marked by incertitude and by those who save a lot and can distribute their risks by diversifying their portfolios and proceed to instantaneous arbitrations.

All companies exposed to competition are inclined to notice a minimum of discretion on these trumps, preferences or strategic choices not in order to surprise their competitors or to gain a contract or important orders. An enterprise remains somehow opaque in order to defend itself against competition. And it is contraindicated “to say everything, everything in time”.[15] They often make enterprises cross a major crisis in order to reveal these real difficulties.[16] A premature disclosure of these difficulties risks aggravating choices in closing ways to eventual remedies. These discordances limit the contribution by which financial markets ca bring their contribution directly to the economic growth of countries that cross the expansion of their enterprises.

The financial market efficiency favors the instantaneous allocation of resources within a static analysis. This is a reason of the concentration on the elimination of improvidence by the liberty of procedures for profitable transactions.

The extension of the general equilibrium model of the capital market paradoxically attributes value to listed enterprises when this model does not grant any consistency to the price difference of any goods on a perfectly competitive market, and the stock value does not explain the real price of the enterprise. It is obvious that a profound, liquid and transparent financial market is likely to favor capital allocations and more information concerning the value of every day resulted loans and projects of enterprises with an open market.[17] The share price acquires a distinct statute as concerns the strong efficiency form: it does not synthetically reflect all information concerning the enterprise value, but is an indicator which does not react alone to the variety of information concerning enterprises and, at the same time, to overall market data.[18]

The financial market corresponds to these descriptions efficiently placed in attenuated forms, by the conditions that justify the existence of game rules as concerns information and authorized by the exchange market which require their compliance. The half-strong efficiency is convenient for a profoundly heterogeneous economy or for industrial and financial groups that replace and complete the markets.

Within this type of organized economy, the capital markets assume the advisor part with several and contradictory operator objectives; liquidity is procured from the exterior in order to resume Hirschman’s terminology (Voit, Voice and Loyalty) with yields which suppose a minimum loyalty among participants. This organized market is found among operators that do not

[15] Boissieu, Societal, 2002

[16] Vezi exemplul raportului Hannezo, director financiar la Vivendi Universal remis COB privind evoluția grupului în perioada 1997; Le Monde, 14.12.2002

[17] Ross, 1987, Guerrien, 2000

[18] Keynes

have the same aversion against risk, the same implicit discount rate, or the same preference between dividends and added value.

In order that a financial market can provide reliable information, it is necessary for the market authorities to insure transparency, liquidity and profoundness. These conditions favor the economic growth and use of workforce. It leads to a larger distribution of high quality financial information, which can reduce the distrust of small holders in stock transactions with their origin functions – in other words, they associate more openly the financial market with the economic performances of enterprises.

However, the improvement of financial information is never radical as wished for. Nevertheless, it is enough for the volume of the assets acquired or desired by financial investments to be forced to correlate to the quality of their information so that games are made before small holders could react in time.

(c) In the third place, authorities tutor the intervention on control modalities as concerns financial information in order to remedy the market imperfections. In a world where the moral hazard is widespread, their vigilance is indispensable. It defines the game rules and the classification of the activity of several intermediaries which operate on the financial markets where they influence decisions. Their control is exercised, first of all, in a direct manner the regulation and publication of information, regulating authorities for the financial markets - AMF, SEC) and then in an indirect manner (deontology, self-discipline).

Or, the financial market is animated by an influence of intermediaries. Their activity is apparently improved by the market transparency and reduction of information asymmetries. They provide services and products adjusted to the needs generated by the two market quotas: that of expert accountants, audit institutions, strategy advisors, financial analysts investment banks, pension funds trustees, mutual funds, speculative funds, departments of patrimony management advisors within banks and insurance companies.

d) In the fourth and last place, one cannot return to values and enterprise evaluation without underlining three characteristics given by the current crisis, which show the relative importance of novelties.

• Several enterprises present the “new economy” and MTT (medium and telecommunication technologies) looking for external financing in order to profit as soon as possible of the “profit equations”[19];

• Intangible assets (patents, logistics, trademarks, personnel skills, contracts, etc.) obtain a more and more particular importance during the technological revolution period;

• Enterprise relationships cover a large variety of possibilities to overpass the width of the competition field, of an expected competition in the sense of frontal rivalry.[20]

Conclusions

In conclusion, if it is indispensable to ensure transparency of financial markets, hope can be placed where they meet the limits they operate within. Transparency depends on the achievement of two conditions: the publication of the accounts in a sincere and objective manner; the insurance

[19] Procter, Cohen

[20] Bienayme, 2003

that everything is legally available at any moment to the same information on results and perspectives of enterprise evolution. It prevents the deformed propagation of information and keeps a good watch on enterprises, so that they cannot hide data they should give to the market. Or, the accounting and financial information did not particularly revealed the trumps and handicaps of companies and market evolution factors. These dissatisfactions are based on two reasons. On one hand, the logic of an enterprise which acts in different periods from those of the financial market that animates actors at different and unstable horizons. An enterprise cannot raise again the question of data updating according to which it based its strategically important decisions; investors are freer to move in this area. On the other hand, the notion of transparency, if taken on paper, allows obtaining simple prices (COB). Transparency of financial analyses is opposite to the synthesis needs of the market actors. In this respect, the activity course ceases to provide a synthetic indication, sufficient in different interpretation and comment reasons, with events and acts mark the enterprise life.

Therefore, transparence is not light. To the extent in which transparency is an efficiency condition of the financial market, the latest remains inaccessible, as a strong form.

In other words, like Roland Barthes who affirmed about Racine's heroes: "Transparency of an ambiguous value: it is given and nothing says and can say."

Generally speaking, the objectives of accounts and publicity of market operations provide indisputable advantages to establish a favorable climate of economic efficiency in the development of capital markets. It is more comprehensible that the enterprise is judged according to the quality of its products by its clients; at the same time, it can admit as legitimate the fact that investors appreciate regulate quality intervals of enterprise management to which they entrust their funds. In this respect, the measurement of regulations imposed by the United States (the Sarbanes-Oxley Law- July, 2002) and Europe (the Law on financial security in France) is generated by reinforcement reasons of information objectives and transparency of financial operations.

However, for their justification they concern the immediate interests of investors, and do not end by a time discordance which belongs to the own nature of the capitalist system.

The progress achieved in the stock telecommunication and computerization accelerates the market transactions, without disturbing laws that govern the strategic balance of firms, maintained and improved by their competitive skills.

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