

ECONOMIC POLICY IN CONDITIONS OF GLOBALIZING ECONOMIC CRISIS*

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Abstract. *At the beginning of the 21st century, current global economic crisis is the biggest challenge for economists who sit in governments around the world, and especially for those in the governments of developing countries. A task, at the same time challenging and very difficult, was placed before them, and that is, most certainly, to suggest and create sound economic policy measures to minimize negative impacts of global economic crisis on the national economy. In addition to minimizing the negative impact of the global economic crisis, it is necessary to create such economic policy measures that will stimulate long-term economic growth of the country.*

Key Words: *Global economic crisis, economic policy, the limitations of monetary and fiscal policy.*

INTRODUCTION

The regulation of financial markets has once again proved that it is powerless to protect the system and keep it stable. Financial upheavals throughout history carry the hallmark of the systems whose regulation is ineffective. This inefficiency is registered only after the upheavals that occurred [4, pp. 629-633; 5, pp. 338-339] after the quake followed by a set of corrective measures that will in time show their inability to effectively correct deficiencies of the existing regulatory system. So the problem related to financial turbulence in economies around the world linked to the regulatory system is inefficient, ineffective and short-term reform of the regulatory system.

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The theory of an efficient system of regulation means that the system includes:

1. reality system which regulates;
2. preventive measures;
3. corrective measures;

Reality system implies that the regulation is based on real conditions that exist in the system. Negative conditions should be minimized, and positive conditions encouraged. In no system as in the financial system, do these conditions express such a strong influence on changes in the system. Small negative signals are transmitted very quickly and endanger those who are not related. Similarly, in a lesser degree, it happens with positive signals.

Preventive measures must be provided for the regulation. However, these measures would constantly have to be subordinated to audit and adjustments due to rapid changes in the system that is being regulated. The correction of the regulatory system provides for the regulation itself. In modern terms this can be somewhat slow, and in the worst case even prevent the efficient correction of the existing regulatory system.

Contemporary regulation of the financial system shows shortcomings in all these three segments. The most difficult case is when the reality of long-term bypass regulation of the financial system and thereby control itself leads to the inefficiency of the system or to its failure in the long run. The modern financial system, based on interest as the price of capital, shows many weaknesses. It is reasonable to question whether such a system should still allow you to work.

Interest income adapted to people to acquire money does not work, because while a man with interest may be making a large income, he will avoid investment of his money in projects that require effort and risk. This statement is certainly general and its theoretical and empirical argumentation is required.

INADEQUACY OF THE FINANCIAL SYSTEM - A KEY CAUSE OF THE GLOBAL ECONOMIC CRISIS

As we initially assumed, interest rate is an obstacle for any economic activity. For who will, for example, withdraw the money from their savings account with the interest rate of 6% and invest in a project that carries a small contribution? Only by diminishing interest rates investments that were made before will be allowed, however they were reasonable or necessary. On the other hand, the market can meet any investment, which leads to drop-down yield investments, thereby reducing earnings, and interest costs remain constant.

This reduces the yield of the invested money to or below the level of interest rates for loans, because businessmen will not take the risk, but will invest their capital in the banks and thus gain safe return. This way of thinking can be shown using the net present value method. Suppose that a businessman was to consider whether to invest his money into a project (for example: opening a factory or buying machines) or to leave his money in the bank. He knows that the bank will receive an interest rate of 7.5%. So this project must achieve at least this offering. Table 1 shows this calculation. If the businessman were not to seek any interest rate or a minimum fixed return, earnings from this project would be sufficient to pay off the money. Businessman would earn 15,000 dinars with this project. But because our merchant has an alternative to deposit his money in bank savings, he dis-

counted cash flow each year. After this calculation he will find that this investment has a negative net present value. This means that it can not make the desired output. In this case the internal rate of profitability of investment is 5.4%. Since this is less than the merchant can receive safely in the bank, he will not make this investment.

Table 1. Assessment of investment method with the net present value (with interest) and analysis with no interest

	No interest	With interest
Interest rate	0%	7,5%
Expenditures for investment	100.000 RSD	100.000 RSD
Earnings year 1	30.000 RSD	27.907 RSD
Earnings year 2	25.000 RSD	21.633 RSD
Earnings year 3	25.000 RSD	20.124 RSD
Earnings year 4	20.000 RSD	14.976 RSD
Earnings year 5	15.000 RSD	10.448 RSD
Net present value	15.000 RSD	-4.911 RSD
Return on investment		5,4%

Also, the growing indebtedness of companies of interest leads to a reduction of economic activity. Responsible companies often can not earn interest due to the additional costs, especially when interest rates suddenly rise. As in the saturated markets and markets with strong competition entrepreneurs have only a small profit margin, they do not have the ability to increase prices. This reduced profitability of enterprises leads to the fact that an increasing number of businessmen do not take business risks and therefore prefer a fixed income from interest.

Since economic activity and the number of (small) businessmen is reduced, thus is reduced the number of jobs. This is very problematic, since small and medium-sized enterprises primarily create jobs, while large companies often reduce their labor force.

On the other hand, liquid companies with relatively low debt find it often more attractive, especially at high interest rates, to invest their money in capital markets, and create new jobs through investment. For example: company Daimler-Benz during the high interest rates in the year 1981 generated more revenue through investment of liquid assets (primarily interest income) than from selling cars and trucks. [3, pp. 180] The same is true for other large companies during the eighties of the twentieth century in Germany. Financially strong companies are able to increase their earnings from interest income primarily on account of charge to the company, which must pay the interest due to their greater dependence on the loan. Therefore, they can easily buy these companies, or, rather, push them out of the market, as responsible companies have less flexibility in costs. In this way the concentration of companies accelerates and ultimately destroys the additional jobs. This shows that interest rates lead to reducing the number of enterprises in market economies, thereby becoming more dependent on a small number of large companies.

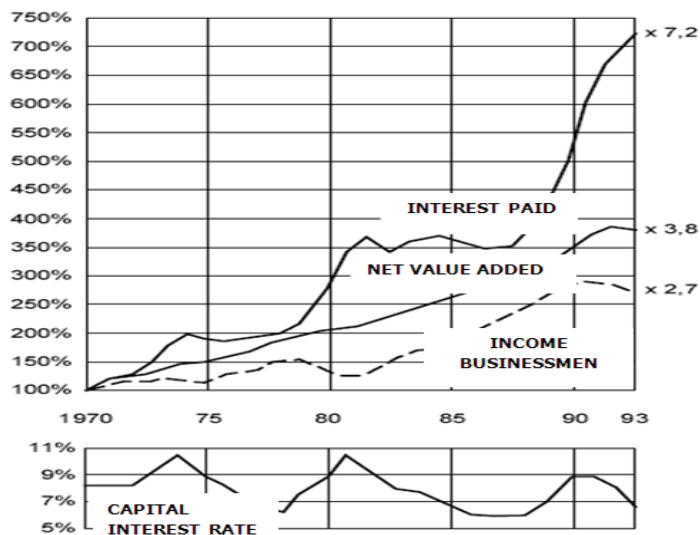


Fig. 1 Comparison of interest costs of companies with their earnings in Germany
Source: [3, pp. 116]

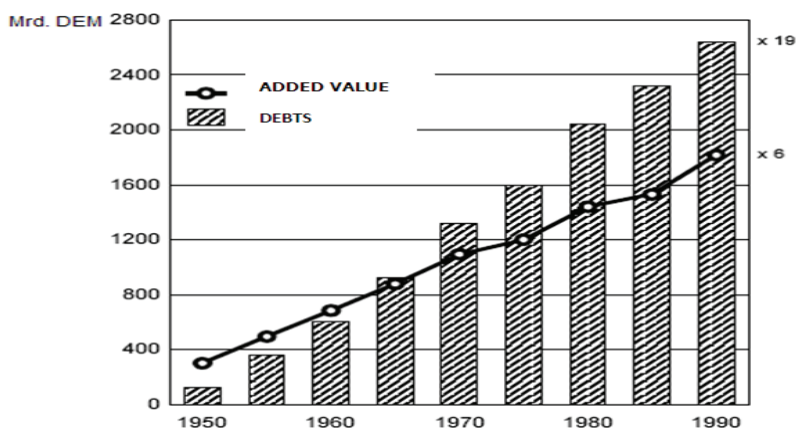


Fig. 2 Comparing the additional value and debts of enterprises in West Germany
Source: [3, pp. 93]

The functioning of modern financial systems shows that the negative consequence of interest is one of the causes of quakes in them. The last financial earthquake, as the largest drop sampler in world economy since the end of World War II, shows unsustainability of this way of functioning of the financial system. The fact is that interest rates fell sharply and gave a clear signal that we need something more than regulatory adjustments.

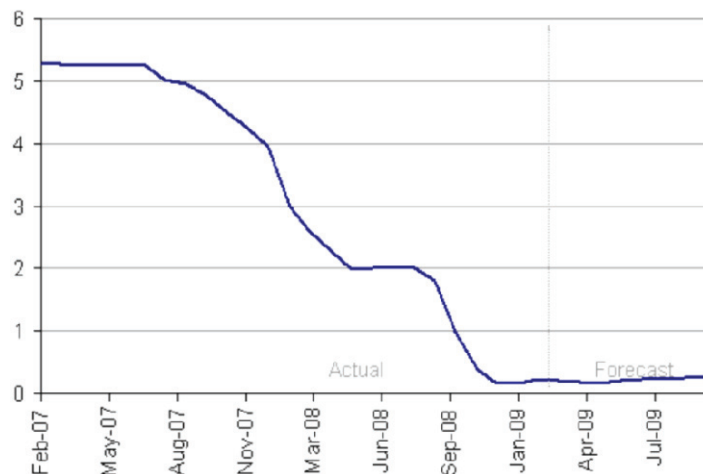


Fig. 3 Federal Funds interest rates

Source: Financial Forecast Center

Such a drop in interest rates is a signal that the regulatory system, unless there is a valid correction, following the consequences of financial crisis will further deform the real economy and further encourage recession. Extensive actions of regulatory bodies are required to limit such negative consequences.

Despite such shortcomings, the current financial system can not be fundamentally reformed in the short term. The possibility for the economists who sit in governments worldwide is to create appropriate measures to promote a positive business climate and minimize the negative business climate.

MEASURES WHICH ACT ON THE GLOBAL ECONOMIC CRISIS?

Measures of economic policies that were in effect before the arrival of the crisis became practically not valid. Ended their "time" or duration of their effect on the economy has become negative. In this set of circumstances governments are faced with a difficult challenge: ease the crisis and ensure further economic growth. An additional problem is represented by lag effect that occurs in most measures of economic policy.

Before making decisions about the design and implementation of any measures necessary to diagnose the state of the economy, identify the origin of the crisis and its time course. Economic growth became negative in most of the countries in 2008. Earlier warnings came from the world market that crisis was announced, but these were not related indicator of the ways countries with high rates of growth. However, the data show that these countries have the highest crash rates of growth of GDP (Latvia in 2007 ended the year with a growth rate of GDP of 10%, and at the end of 2008 the growth rate was negative and amounted to -4.7%).

Table 2. Real GDP growth rate - Growth rate of GDP volume - percentage change on previous year

GEO	2005	2006	2007	2008	2009	2010
Belgium	1.8	3.0	2.8	1.1	-3.5 ^{f*}	-0.2 ^f
Bulgaria	6.2	6.3	6.2	6.0	-1.6 ^f	-0.1 ^f
Czech Republic	6.3	6.8	6.1	3.0	-2.7 ^f	0.3 ^f
Denmark	2.4	3.3	1.6	-1.2	-3.3 ^f	0.3 ^f
Germany	0.8	3.2	2.5	1.3	-5.4 ^f	0.3 ^f
Estonia	9.4	10.0	7.2	-3.6	-10.3 ^f	-0.8 ^f
Ireland	6.4	5.7	6.0	-2.3	-9.0 ^f	-2.6 ^f
Greece	2.9	4.5	4.0	2.9	-0.9 ^f	0.1 ^f
Spain	3.6	3.9	3.7	1.2	-3.2 ^f	-1.0 ^f
France	1.9	2.2	2.3	0.4	-3.0 ^f	-0.2 ^f
Italy	0.7	2.0	1.6	-1.0	-4.4 ^f	0.1 ^f
Cyprus	3.9	4.1	4.4	3.7	0.3 ^f	0.7 ^f
Latvia	10.6	12.2	10	-4.6	-13.1 ^f	-3.2 ^f
Lithuania	7.8	7.8	8.9	3.0	-11.0 ^f	-4.7 ^f
Luxembourg (Grand-Duché)	5.2	6.4	5.2	-0.9	-3.0 ^f	0.1 ^f
Hungary	3.9	4.0	1.2	0.6	-6.3 ^f	-0.3 ^f
Malta	4.1	3.8	3.7	2.1	-0.9 ^f	0.2 ^f
Netherlands	2.0	3.4	3.6	2.0	-3.5 ^f	-0.4 ^f
Austria	2.5	3.5	3.5	2.0	-4.0 ^f	-0.1 ^f
Poland	3.6	6.2	6.6	5.0	-1.4 ^f	0.8 ^f
Portugal	0.9	1.4	1.9	0.0	-3.7 ^f	-0.8 ^f
Romania	4.2	7.9	6.2	7.1	-4.0 ^f	0.0 ^f
Slovenia	4.5	5.8	6.8	3.5	-3.4 ^f	0.7 ^f
Slovakia	6.5	8.5	10.4	6.4 ^(e)	-2.6 ^f	0.7 ^f
Finland	2.8	4.9	4.2	1.0	-4.7 ^f	0.2 ^f
Sweden	3.3	4.2	2.6	-0.2	-4.0 ^f	0.8 ^f
United Kingdom	2.2	2.9	2.6	0.7	-3.8 ^f	0.1 ^f
Croatia	4.2	4.7	5.5	2.4	-3.0 ^f	1.5 ^f
F. Y. R. of Macedonia, the	4.1 ^f	4.0 ^f	5.9 ^f	5.0 ^f	-0.3 ^f	1.5 ^f
Turkey	8.4	6.9	4.5	1.1 ^f	-3.7 ^f	2.2 ^f
Iceland	7.5	4.3	5.6	1.3	-11.6 ^f	1.8 ^f
Norway	2.7	2.3	3.1	2.1	-3.4 ^f	0.2 ^f
Switzerland	2.6	3.6	3.6	1.8	-3.2 ^f	-0.5 ^f
United States	3.1	2.7	2.1	0.4	-2.9 ^f	0.9 ^f
Japan	1.9	2.0	2.3	-0.7	-5.3 ^f	0.1 ^f

*=Not available f=Forecast p=Provisional value e=Estimated value

Source: Eurostat

Overheating of the world economy and the coming crisis indicated primarily disturbances in financial markets. Particularly negative consequences of such disorders were in developing countries where financial markets are still in their infancy. Governments of

wider world have not reacted differently to the consequences of the crisis. A particularly aggravating circumstance is that many consequences of the crisis are not immediately noticeable, but some are absolutely unpredictable and such properties can lead the country to economic and financial collapse.

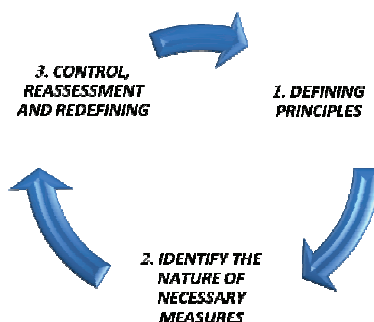


Fig. 4 The process of creation and implementation of economic policy measures in terms of crisis

The creation of economic policy measures and their implementation in conditions of crisis is a complex process that requires constant upgrading. This process could be generally divided into three phases:

1. Define principles of creation and implementation of economic policy measures;
2. Identify the nature of economic measures needed and implement;
3. Control, review and redefine the measures in accordance with the consequences of the crisis that eventually occur.

Defining principles of the creation and implementation of measures of economic policy in conditions of crisis is the starting point. If principles are not valid, the whole process is ruined. It is therefore necessary to define the principles broadly and generally, in order to synchronize with the consequences of the crisis that eventually emerge.

In general these principles can be:

- a. *The principle of timeliness.* This principle implies that certain measures of economic policy should be implemented at a time when they reach maximum possible effect - in a time when there is a minimal number of limiting factors that act negatively on the implementation of concrete measures.
- b. *The principle of consistency.* Measures must be consistent with the other set of measures and policies, both in the short and in the long term. Inconsistent measures lead to additional shocks in the economy.
- c. *The principle of flexibility.* None of the measures of economic policy can not be created or rigidly implemented. Otherwise, negative consequences that deepen the crisis may occur.

These three principles should be accepted as a general truth; however, there are situations when it is necessary to depart from these principles and implement specific measures later, inconsistently or rigidly.

After defining principles, determining the nature of measures follows. Measures which are typically created and carried out under conditions of crisis are [1, pp. 187, 2, 408-420, 6, pp. 718-722]:

1. *Regulatory measures.* Regulation should protect the sectors affected by the crisis and after a certain time pass a new regulation to encourage the development of the given sector (modern examples of such measures as the Emergency Economic Stabilization Act of 2008 / EESA or TARP American Recovery and Reinvestment Act of 2009).
2. *Monetary measures.* Monetary authority monitoring data on the situation in the Financial markets create short-term measures, taking into account that there is no violation of the principle of inconsistency, especially when it comes to the issue of fiscal measures (for example, the UK has approved increasing the limit of guaranteed deposits from 35.000 to 50.000 pounds with the possibility of further increases).
3. *Fiscal measures.* Framework for these measures are regulatory measures, however, the government in any case should not be allowed to leave these measures as part of regulatory measures, but they must be set aside and specifically to create and implement in accordance with the above-mentioned principles (for example, Germany has introduced tax Incentives income for contributions to health and ensured long-term patterns of health care from the year 2010).

CONCLUSION

The current global economic crisis is the biggest challenge to mankind at the beginning of this century. It threatens the human race from the consequences of such turbulences. An approach to its solution which would be carried with a serious dose of disdain for it, would be doomed to failure. Economists who sit in governments around the world should be careful when creating measures of economic policy. This caution means that it is better not to do anything than the wrong thing.

At the mercy of the argument we presented a proof that the current world financial system has inherent long-term weakness. This is not only our observation, but observation of economists who have created and create measures to combat the current crisis. In fact, one of the key tasks of governments, both those in the developed and in underdeveloped countries, was to maintain confidence in the current financial and banking system. Through different sets of measures, most of the governments successfully carried out this task. However, the question is: how valid is such a solution? Did a given set of measures to restore confidence in the current financial system of governments create the conditions for a future onset of another crisis after this one passes? These questions require in-depth analysis. However, most developed countries are silent before this fact, but continually work to reform the financial system on a national scale. This action should be followed by developing countries in order for them not to be brought into the situation that they must re-enter another transition process, but not this time of economic transition, but only of the financial transition.

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KREIRANJE MERA EKONOMSKE POLITIKE U USLOVIMA GLOBALNE EKONOMSKE KRIZE

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Na početku 21. veka, aktuelna, globalna ekonomska kriza je najveći izazov za ekonomiste koji sede u vladama širom sveta, a posebno za one u vladama zemalja u razvoju. Pred njih je stavljen jedan istovremeno izazovan i veoma težak zadatak, a to je svakako da predlažu i kreiraju valjane mere ekonomske politike kojima se minimiziraju negativni uticaji globalne ekonomske krize na nacionalnu ekonomiju. Pored minimiziranja negativnih uticaja globalne ekonomske krize potrebno je kreirati takve mere ekonomske politike koje će dugoročno stimulisati privredni rast zemlje.

Ključne reči: *globalna ekonomska kriza, ekonomska politika, ograničenja monetarne i fiskalne politike*