TOWARD a NEW ECONOMIC ORDER THROUGH a NEV PARADIGM of ECONOMIC GROWTH (REGAINING the CREDIBILITY of the MARKETS)

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Economia mondială revine din recesiunea profundă 2007-2009 cu unele caracteristici neobişnuite: o relansare inertă şi nesigură a economiilor avansate; performanțe impresionante ale piețelor emergente cu o ascendentă viguroasă a țărilor BRIC (acronim format din primele litere ale denumirilor de țări – Brazilia, Rusia, India, China), care formează aşa-numitul club al „economiilor dezvoltate” („growth economies”) şi la care se asociază Mexic, Coreea, Turcia şi Indonezia, cu o contribuție a fiecărei din aceste țări de cel puțin 1% la produsul global. Dar, cel mai important impact criza îl exercită la redistribuirea speranței, erodând confidența în piețele libere şi în modelul capitalismului liberal de tip american, diminuând capacitatea guvernelor de a restabili macroechilibrul printr-o creştere economică susținută, de a reduce şomajul şi a asigura stabilitatea prețurilor, în special la petrol şi la alte resurse energetice.

Pentru a înțelege provocările economiei de astăzi şi perspectivele transformării ordinii economice mondiale, este necesar să regândim însuşi economics-ul, să redefinim unul dintre cele mai importante concepte – creşterea economică – în contextul globalizării şi comportamentului uman, când indivizii, instituțiile sau statul tind să-şi maximizeze beneficiile sau să-şi minimizeze pierderile, confruntându-se cu constrângeri de tot felul şi cu diverşi factori de risc.

Introduction

The Global Recovery of about 4.5% annual increase of global output is characterized by authors of the 2011 World Economic Outlook as the two-speed process, with a subdued 2.5% annual growth in advanced economies for the next two years and much more impressive rates for emerging and developing economies: 7% in 2011 and 6.5% in 2012 [1,2]. The Goldman Sacks experts are even more optimistic regarding the BRIC's prospects, forecasting 8.6% and respectively 8.2% [3]. The weak and unstable recovery of the US economy – 3.0 and 2.7% correspondingly, is due to several reasons: severe deterioration of households' net worth during last three years (by 25-30%); persistent high unemployment rate (9.0%) and restrictive credit policy of banks that are still reluctant to lend. At the same time the challenges and potential of growth economies, emerging and developing markets – once known as the Third World, are obvious: 85% of the World population with the biggest potential and rapidly expanding consumer market; the largest explored reserves of oil, natural gas and other energy and mineral resources; an impressive 7% annual growth rate over the past few years with just a slowdown during recession; a "wall of money", more than $5 trillion in central-bank reserves with much bigger rate of saving in comparison to advanced economies. All of these are inherent components of a new paradigm of the global economic growth that represent the most remarkable transformation at the beginning of 21st century. According to Martin Wolf, the Financial Times columnist "the shift of the world economy that is now under way has literally has no precedent in its speed and scale" [4].

The US economy needs today, perhaps more than ever, booming private investments and booming export, its own BRIC equivalent in words of Jim O'Neill, Chairman of Goldman Sachs Asset Management (GSAM). Projects for growth for the Commonwealth of Independent States (CIS, created in 1991 on the base of dissolution of the Soviet Union) including Russia remain more modest (4.7% in 2011 and 4.6% in 2011), although quite strong, but with another challenge on horizon – rapidly increasing commodity prices, especially for food and oil.

To ensure healthy recovery, strong and sustainable economic growth, according to IMF experts, two rebalancing acts are necessary: internal rebalancing based on increasing private demand in advanced economies, which will lead to fiscal consolidation; and external rebalancing, requiring a rise in net exports in deficit economies, such as the United States, and a decrease in net export in surplus economies, first of all emerging Asia [5]. To understand how these two difficult and intertwined rebalancing acts could be achieved it is important to focus on a new paradigm of economic growth with an emphasis on the advanced economies, first of all that of the U.S., and emerging markets economies.

Causes and consequences of the financial crisis of 2007-2009

The authors of the Global Risks-2011 study - experts of the World Economic Forum (WEF), published on the eve of meeting in Davos, Switzerland (January 2011), indicated two major forces, provoking global risks and generating external and internal imbalances: economic disparity between countries and within states, and poor management on the global scale. These two major risks are complemented by other types of risks: a) macroeconomic imbalances and volatility of the exchange rates, b) illegal economy amounted to $1.3 trillion by 2009 and c) depletion of natural resources, demand and prices for which, especially for food and energy, are expected to increase by 30-50% during next few decades. These major risks are amplified by other types of risks, such as cyber security, demographic volatility and volatility of prices for resources, withdrawal from globalization and proliferation of weapons of mass distraction. Robert Greenhill, the Managing Director and Chief Business Officer at the WEF, considers that "Twentieth century systems are failing to manage 21st century risks; we need new networked systems to identify and address global risks before they become global crises" [6].

To assess the real size and threat of disasters that open capital markets might create in combination with un- or poor regulated financial sectors and identify risk prevention mechanisms it is important to focus on the causes and consequences of the Financial Crash of 2007-2008, the deepest after the Great Depression of 30s.

This extraordinary financial shock that started in August 2007 as the U.S. subprime mortgage market collapsed caused a significant slowdown of the world economy, an alarming drop in global growth (by 6.3% in the last quarter of 2008 - a swing from 4% growth one year earlier) with a decline in 2009 (by 0.6%) - the first contraction since WWII, and reemergence of growth in 2010 (5.0%) mostly due to continues performances of emerging markets [7].

Analyzing the roots of the crisis of financial system, it could be concluded that these problems had been cumulatively accumulated during last decades. Martin Wolf, the author of Fixing Global Finance - one of the most detailed and profound analysis of the global financial system weaknesses, mentioned that "the failure of the past led to the so-called imbalances of the present" that were at the core of the recent financial crisis. He described it as the outcome of series of "obvious failures" to understand and appreciate the inherent risks of: a) liberalized financial markets and market-oriented institutions' decisions; b) finance that crosses frontiers, especially for fragile emerging markets economies; c) borrowing in foreign currencies by debtor countries and that of missing greater fiscal and monetary discipline; d) the volatile exchange rate, undertaken by both creditors and debtors in a world of liberalized capital movements; and e) of not acting to modernize the global institutions at the right time.

The finance is the engine of a dynamic, open and sophisticated market economy, some sort of "pyramid of promises" that sometimes are not kept. According to M.Wolf, by the end of 2005 the total financial assets owned by the U.S. private sector equals $52 trillion, and with those of Eurozone ($30 trillion), Japan ($19.5 trillion) and UK ($8 trillion) formed about 80% of the world total of $140 trillion. This represent 316% of the world output, up from just 109% in 1980 and 218 in 1995. For the U.S. this figure is even more impressive: 405% [8]. The bigger is this gap between the financial sector and the "real" economy – the more risky become financial games and manipulations, especially with the exotic financial instruments known as over-the counter derivatives, the more inherent become the risk of crush, and, when it occurs, it is much more spectacular than whatever was noticed before. Cumulatively during years of the recent crisis Americans have lost 33% of their largest and most valuable asset – equity in their homes (valued at $13 trillion at their peak in 2006 to $8.8 trillion in 2008), 22% in the total retirement asset, - the second largest household asset (from $10.3 trillion to $8 trillion), $1.2 trillion in savings and investments and $1.3 trillion in pension assets. These losses together reached a staggering $8.3 trillion [9].

But the most striking conclusion came from the 545-page report of the U.S.Congress Financial Crisis Inquiry Commission: the 2007-2009 financial crisis was an "avoidable" disaster caused by widespread failure in government regulation, corporate mismanagement and heedless risk-taking by Wall Street [10]. It should be mentioned that three members of this Commission came with a separate opinion, considering its conclusions "simplistic explanation of a complex problem" that "will ultimately lead to mistaken policies". They believe the crisis was the product of 10 factors: 1) a broad credit bubble in the U.S. and Europe: 2) sustained housing bubble in the U.S.; 3) increase in nontraditio0nal mortgages; 4) transformation of bad mortgages into toxic financial assets; 5) enormous concentration of highly correlated housing risk; 6) funding the exposures

to risk with short-term debt; 7) risk of contagion; 8) common shock; 9) financial shock and panic and 10) severe contraction in the real economy [11].

The paradoxical effects of this crisis are still dominating the agenda of the G-20, World Forums, and other international institutions, scholars' research and debates, requiring a reassessment of the role and power of the developed and emerging markets, a new Post-Washingtonian Consensus. The most important consequences of this crisis, in opinion of Nancy Birdsall and Francis Fukuyama, are: the "end of the foreign finance fetish"; "a new respect among developing countries for the political and social benefits of a sensible social policy"; a renewed discussions about necessity of a new industrial policy, of private investments in a new industries and technologies; and vital necessity to reform public sectors if "countries are to promote industrial development and provide a social safety net" [12].

Obviously post-Crisis period will be recorded as one that will challenge (and eventually reshape) the existing global financial system with its most critical issues: deep and prolonged asset market collapses; profound declines in output and employment, and the big jump in the real value of government debt, on average, by 86% [13]. Creating a 21st – century regulatory system is the most pressing requirement and response to the crisis. As the U.S. President Barack Obama stressed, this means "writing rules with more input from experts, businesses and ordinary citizens. It means using disclosure as a tool to inform consumers of their choices, rather than restricting those choices…We can make our economy stronger and more competitive, while meeting our fundamental responsibilities to one another" [14].

The financial and banking system policies represented the most powerful U.S. administration policy reaction to the crisis, implemented through conventional and unconventional monetary policies, bank "stress tests", bailouts of a few banks and financial institutions. The problem, as Frederic Mishkin, professor at Columbia University, emphasized, was in modus operandi of the Fed during the crisis: "massive experimentation in an unprecedented situation: that is, it was employing a large number of measures to contain the crisis, not knowing exactly which ones would work" [15].

Redefining the role of emerging markets in post-crisis global recovery

The paradox of the 21st century, as the Global Risks – 2011 study emphasizes is the fact that the "the world is not only being integrated during the globalization process, but is also becoming more disconnected as the majority of the fruits of globalization are enjoyed by the minority" [16]. The "decoupling" trends are illustrated by the increased disparities between the core of Europe and its periphery, between the real economy and its financial stresses, between emerging and advanced economies. Nevertheless the global economy is still tightly interconnected and its rebalancing lead relentlessly to a new paradigm of growth, shifting the economic gravity to the emerging world. The latest Economist's special report on the world economy pointed out at three main reasons that explain "stagnation of the West and the emergence of the rest":

- ✓ First, the sheer scale of the recent recession and the weakness of the following recovery with a high rate of unemployment and high degree of unused capacity expressed in persisting output gap as % of potential GDP;
- ✓ Second, a slowing supply of workers due to ageing population, especially in western Europe and Japan with a little bit better demography in the U.S., and flat or slowing productivity growth due to declining rate of capital investment and sluggish pace of innovations – a combination that could decrease the economic growth to just 1.45% during next decade (from 2.1% between 1998 and 2008), the slowest pace after the WWII;
- ✓ Third, the economic potential is damaged by hangover from the crisis and feebleness of recovery that may reduce the rich countries' output by some 3% and situation may deteriorate furthermore if their governments will not foster growth by supporting short-term demand and boosting long-term supply, seen by policymakers sooner as alternatives rather than complements, unfortunately [17].

A striking fact becomes obvious: emerging economies have performed better after each of the last five advanced economies recessions: 1974-75, 1980-83, 1991-93, 2001. They also become more correlated with advanced economies growth rate, based on purchasing power parity. This surprising pattern of improved economic growth after each subsequent recession is confirmed also by the comparatively better performance of emerging economies after the current recession. The authors of the October 2010 World Economy Outlook pointed out to three indicators: a) growth difference (the difference between the economy's average growth

rate in the three years after the recession and its average growth rate three years before recession); b) level differences (output lost from the shock: difference between the level of output three years after recession and the trend level on the seven years of output growth before recession) and c) relative growth (difference between the average growth rate during the three years after the recession for a concrete emerging economy and the average advanced economy of 2007-09 [18]. To be mentioned that strong growth from the productivity gains and continuing integration of emerging and developing economies into the global economy as well as stabilization gains from significantly improved macroeconomic policy framework are "the secrets" of the resilience of these countries to the global financial crisis of 2007-2008 [19].

All these tendencies require a redefinition and differentiation of the role of emerging markets in a post-crisis recovering, taking into consideration that 40% of recent global consumption and more than two thirds of global growth are accounted with these markets. From this group of countries eight were "graduated" recently by Goldman Sack's experts from "Emerging" to "Growth Markets", the 'threshold' being at least 1% of the current global GDP (around $600 billion). Along with the four BRICs countries to this category were attributed Mexico, Korea, Turkey and Indonesia with good prospects for Nigeria, Philippines to join this club by mid-2040s and in more distant future – Egypt and eventually Iran. All these eight countries (with exception of India) have good essential growth conditions. Their growth is driven mostly by internal consumption - an annual increase by $800 billion, which could overcome the U.S. consumption ($10.5 trillion) in the next 10 years [20]. Their combined nominal GDP could reach $16 trillion by 2019 and be similar to each of that of the U.S. and the Euro area with at least ¾ of this increase coming from the BRIC, and ½ of it alone from China [21].

Michael Spence, Nobel Prize winner in economics, mentioned in his recent book "Next Convergence": "The huge asymmetries between advanced and developing countries have not disappeared, but they are declining, and the pattern for the first time in 250 years is convergence rather than divergence". The world economy in his opinion needs enhanced coordinated oversight" and "global effective government" to make progress on the New Architecture [22].

Prospects and limits of the BRICs in global recovery

To understand the prospects and the limits of a strong growth momentum, which is on the base of a new global growth paradigm, especially important is analysis of the growth in productivity – an increase in output from a given quantity of inputs, - a driving force of economic growth and key factor for the growth economies, including BRIC, emerging and developing markets' long-run prospects and their new role in the world economy. The Goldman Sack's (GS) economists analyzed the productivity's growth in these countries by using Growth Environment Score (GES) model as a process of catch-up to the developed economies. This index is based on 13 variables critical necessary for sustainable economic growth and productivity, it is a proxy of the economic, political and social conditions required for the convergence in productivity growth rate with the developed economies [23]. The higher the GES – the higher is the growth rate of productivity and the better and faster is the convergence. The GS experts expect BRIC's productivity to outperform both developed markets and other emerging markets. Over the past decade the productivity average growth in these countries was 3.0% per year, being particularly impressive in Russia (6.7%) and China (3.5%). This reflects the BRICs recent performance in the following five components of GES:

- ✓ Human capital (increased in life expectancy, secondary school enrollment etc);
- ✓ Technology (rapid increase in the number of Internet users - 66.6 per 100, computers – 20 and phones 6.3 since 2000) [24];
- ✓ Political conditions (productivity growth has been encouraged by privatization, trade liberalization and financial openness, removal of economic rigidities in Russia etc);
- ✓ Macroeconomic conditions (an impressive increased in investment in China – 40% and India – 35%); and
- ✓ Macroeconomic stability (great strides in Brazil, China and Russia in reduction of high inflation, large government deficit and reliance on foreign borrowing).

The BRICs and EMs in general are benefiting from the breakthrough innovations that are becoming one of the major driving forces of their fast growth. According to the UN World Investment Report there are more than 21,500 multinational companies based in the Ems, many of them being leaders in the respective

industries: China's BYD in batteries, India's Arcelor Mittal in steel, Brazil Embrayer etc. The number of companies from BRICs in the *Financial Times* 500 list quadrupled during last three years (from 15 to 62). There are already some areas where the EMs are ahead of the advanced markets, such as mobile money (using mobile phones to make payments), using computer's programs to recognize handwriting, designing products and organizing process to reach billions of consumers, reinventing systems of production and distribution and proposing total new business models. Business innovations from EMs are challenging and change the advanced world also. This is the region to which Churchill's famous phrase is perfectly applicable: sees opportunity in every difficulty rather than difficulties in every opportunity. The four main factors of the disruptive power of innovations in emerging markets, according the authors of The Economist's special report are:

First, much more liquid and transparent markets for corporate control and senior managerial talents than they were two decades ago (access to public and private developed capital markets, experienced investment bankers and consultants and increased number of mega-bids, such as Tata Group's acquisitions of British Jaguar Land Rover and Corus Group – $2.3 and respectively $12 billion);

Second, the sheer size of the emerging markets with the world recognized export oriented leaders in practically every industry (Arcellor-Mittal in steel; Infosys and TCS in IT; Haier in home appliances; ZTE, mobile-handset makers);

Third, the big impact of the volume of the market (Chinese and Indian mobile phone companies are adding each month 8-10 million new subscribers; Infosys and ZTE are growing at more than 40% a year);

Fourth, the biggest West companies are increasingly looking for the potential of emerging markets not only as sources for assembling and manufacturing, cheap labor force, but as sources of innovations and growth ("Cisco East, General Motors, Microsoft etc). The time when Americans dismiss the Japanese cars n the 80s as "little shit-boxes" (Henry Ford II) is over and perhaps forever.

"The weaknesses are the continuation of the strengths", a proverb says. It is important to explore and to use the potential of emerging markets in reversing the crisis of the world economy. But at the same time it is equally important do not overestimate this potential and nourish illusions that the world economy could be "saved" from this recession by the "Rise of the Rest", using Fareed Zakaria phrase from his famous book [25]. Chinese Premier Wen Jibao, speaking for the World Economic Forum in Davos (Switzerland), lowered the expectations that China can "extract the world from the economic crisis". Like other emerging economies, it remains still too poor and to export-depended to provide a real buffer for the global economy at least in the next few years. For example U.S. consumers have powered more than tenth of global growth in last decades and spent about $9.5 trillion (2007), or six times as much as Chinese and Indian consumers. Even China's massive stimulus program won't change very much the situation. As Stephen Roach, Asia chairman for Morgan Stanley emphasized "you don't create a consumer culture overnight" [26].

Toward a new paradigm of the global growth: learning from the experience of emerging markets

The global financial crisis has one of the strongest negative effect on emerging markets of the former communist countries of Central and Eastern Europe/Southeast Europe (CEESE) that represent the "Achilles' toe" of United Europe, or putting it in more familiar form - a "Europe's version of the subprime market". The abrupt change of the fortune occurred after a surprisingly rapid growth of these countries since the fall of the Berlin Wall.

The financial crash of 2007-2008 marked the largest reversal of economic fortune for these markets due to three major shocks: a) financial turbulence, which greatly limited access to external funding; b) slumping demand from advanced economies, and c) related abrupt fall in commodity prices, specifically for energy resources [27]. Along with the main causes of crisis, rooted in fundamental, system problems of the world economy, there were some specific apparently paradoxical Russian circumstances. The Russian economy was characterized by favorable macro-economic environment, double surpluses (budget and balance of payment), significant increase of foreign currency and gold reserves. This make the situation quite different in Russia's economy in comparison to the crisis of 1998 and Russia's response to crisis was much more efficient:

- ✓ The biggest part of the external debt before the crisis of 2007-09 was not in short-term securities, which affected immediately the market in 1998, but in credit debt;

- ✓ The volume of Foreign Currency Reserves reached about $590 billion, the world's third largest was incomparably higher than in 1998 (about $10 bln.in 1998) and establishment of the State Stabilization Fund served as a strong bumper to crisis;
- ✓ The main characteristic of the recent crisis was different also – an institutional one in, because the main part of the debt was not the public, but corporate debt and private sector, in theory, is responsible for solving its own problems [28].

Russia definitely coped better with the crisis, reemerging to its pre-crisis level much faster than other economies. Not accidently Mr. A.Kudrin was awarded by the IMF at its recent meeting in Washington, D.C. as "the best finance minister of the year". Nevertheless, in his opinion, there are still important issues that need to be addressed: a) gradual liberalization of the flows of capital, labor and commodity; b) reduction of the excessive interference from the state in the economy, particularly through stakes in major companies and corporations; c) poor quality of the state-run regulatory agencies and insufficiently clear regulation with a persisting administrative barriers that lower competition; d) accession to the World Trade Organization, still blocked by different reasons, mostly political [29]. To solve these problems is important also if Russian authorities want to reestablish the trust of foreign investors and credibility of their policy, to enforce the rule of law and protection of property that were and still are the most vulnerable points of Russia's business environment. Russia today, according to the UNCTAD report, is in the list of top five best attractive countries for the Foreign Direct Investments (FDI), behind China, India, Brazil and the U.S. Paradoxically the sum of FDI declined drastically over the last few years: from $130 bln. in 2007 and 2008 to $38 bln. in 2009 and just $5.4 bln. in the first half of 2010 that is equal to monthly investment in China [30]. This happened in spite of a several purely Russian benefits, advantages for investors comparative to other developing markets: a) clearly undervalued Russian securities (they are traded well bellow the price/earning ratio norm – at ratio 7x, while India's, Brazil's and China's are well above: 21x, 15 x and 14x respectively [31]; b) stable macro-economic situation; c) low ratio of debt/GDP – under 10%, which is well below other G-8 and G-20 countries.

The U.S. – Russia economic relations have a great potential, which is still grossly underutilized. Russia is the world's 8th largest economy, but only number 25 among America's trading partners. In 2009 the U.S. – Russian bilateral trade was only $25.3 billion, or about one-twentieth of the U.S.- Chinese trade. Only 4% of FDI in Russia came from the United States. There are a few encouraging signs of the reevaluation of the bilateral economic relations, such as PepsiCo, decision to invest $1 billion in Russia, the $2 billion contract between Boeing and Russian Aeroflot signed during Joe Biden, U.S. Vice-President recent visit to Moscow [32], an initiative on cooperation in energy efficiency and the resubmission to the U.S. Congress of a bilateral civil nuclear energy deal. The recently passed by Russian Duma legislation on Skolkovo Project that is supposed to become a Russian version of California's Silicon Valley, is opening good opportunities for the U.S.-Russia cooperation in energy efficiency and conservation, nuclear technology, space technology, medical technology and strategic computing. But these are just a few examples of a "modernization partnership" with the U.S. that as the Russia's President Dmitry Medvedev stated is a top foreign policy priority [33].

Conclusions

First, the main lesson from the current recession "isn't about market failure or the downside of open borders for capital. It's about the importance of a sound economic policy" [34]. In this respect the role of the government should be reconsidered in rescuing the financial system, in insuring its sustainability, integrity and transparency. "Economies need a balance between the role of markets and the role of government- with important contributions by nonmarket and nongovernmental institutions", as Joseph Stiglitz, Nobel Prize winner in economics wrote in his recent Free Fall [35].

Second, learning right lessons of this and past crises it is important for advanced economies first of all, and especially for the U.S., taking into account its unique role in the world economy and responsibility for solutions to the global financial turmoil. This credit crunch provided at least four important lessons, according to Sylvester Eijffinder, the Dutch Professor of Financial Economics at Tilburg University and Board member of the European Banking Center in Tilburg:

- ✓ the top management reward and remuneration has been excessive,
- ✓ the risk management models based on Basel II have proven to be inadequate,
- ✓ the financial supervisors in the U.S. and Europe have not been involved thoroughly enough and
- ✓ the U.S. framework of financial supervision has proven to be much fragmented and totally ineffective [36].

Third, the global financial crisis marked an historic momentum: the beginning of restructuring of the global financial system by addressing its most vulnerable aspects and existing imbalances and weaknesses, and launching a new paradigm of the global economic growth. There is no doubt about the decisive role of a new global alliance of advanced economies, growth and emerging markets in addressing the consequences of the 2007-2009 financial crisis. It is a right time to propose a "new paradigm for financial markets", in George Soros' words [37].

Fourth, in the next few years global financial crisis will ceased to be a major factor in determining the pace of economic activity, individual and organizations'' behavior, as already happened in emerging and developing markets, a country-specific productivity and sectoral factors will become the most important factors of a new paradigm of economic growth, as suggested the authors of recently published World Bank Report [39].

These ideas and conclusions are at the core of a new Behavioral Economics that could gain momentum in the post-crisis recovery of the global economy, in the search for new engine of economic growth and prosperity. As underline authors of Crisis Economics Nouriel Roubini and Stephen Mihm: "Ideas matter, and without an understanding of the economic ideas in play during the recent crisis, it's impossible to understand how we got into this mess and, more important, how we can got out" [38].

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