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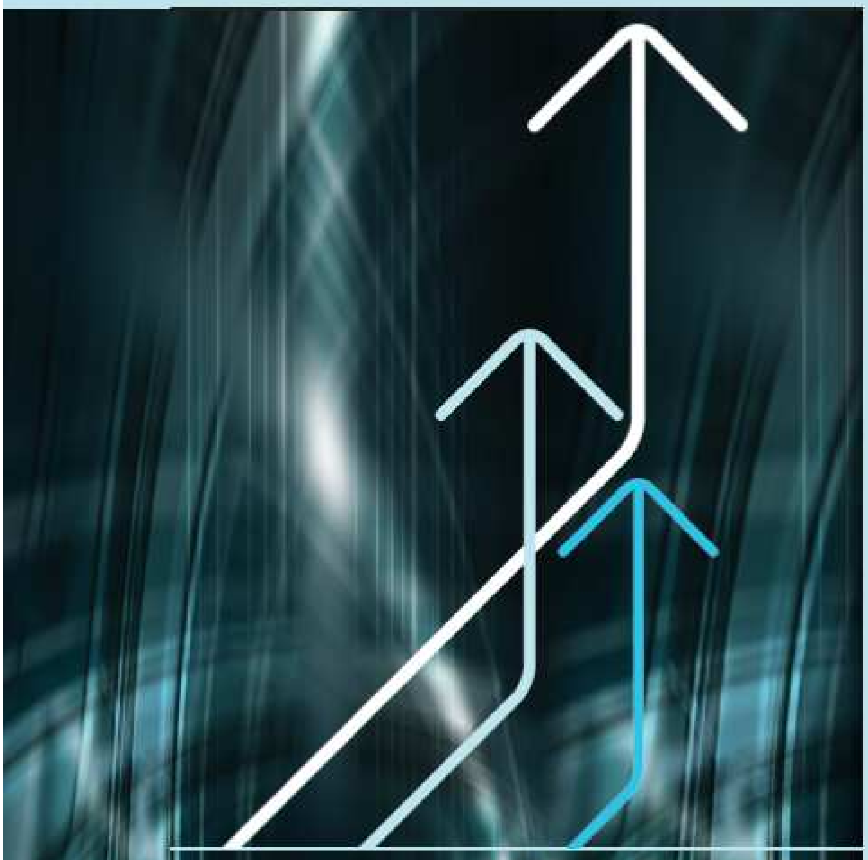

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“VICTOR SLĂVESCU” CENTRE FOR FINANCIAL
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FINANCIAL STUDIES

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CONTENTS

A FORAY INTO THE TANGLE OF GLOBALIZATION MEASUREMENT

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Abstract

The concerns over globalization and its impact on the different aspects of life amplified over the recent years and generated the need to measure this phenomenon so as to know its effects and to get prepared to manage them. This paper makes a critical presentation of the main indicators that measure the phenomenon of globalization and selected one indicator, seemingly the most comprehensive, and applied it to Romania in order to see its rank when comparing with other countries, according to the values of the indicator and its components.

Keywords: globalization indices; economic, social and political globalization

JEL: F60, F69

1. Indices of globalization – identification and description

As many developing countries were only recently involved in the global economy, the concerns for the phenomenon of globalization and its impact on the different aspects of life amplified over the recent years. This prompted the need to measure the phenomenon of globalization so as to know its effects and to get prepared to manage them.

The measurement of the cultural and environmental elements, of the economic and political factors is a real challenge, and the task gets even more difficult if we also include the phenomenon of international integration. Several proposals were done for the construction of

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globalization indices that attempt to capture the relation between international integration and the social progress.

At the beginning, several papers have been published, with a special focus on **competitiveness** and **international opening**, such as the World Economic Forum's indicator of competitiveness, which appeared in 1979 (Lopez-Claros et al., 2006), the studies of Gwartney and Lawson on the economic liberty (1996, 2006) and the globalization index (G-index) developed by the World Market Research Centre (Randolph 2001). G-index measures the depth, extension and interdependence between the national and global economies. Most variables describe the economic dimension of globalization.

The indicators constructed by the **Organisation for Economic Development and Cooperation** (OECD) are intended to measure the magnitude and intensity of the economic globalization in four areas: international trade, direct foreign investments, activity of the multinational companies and the international generation and dissemination of technology.

The **index of globalization A. T. Kearney/FOREIGN POLICY** is generally reckoned as the first proposal for a composite, multidimensional indicator of globalization, supported by a statistical database. It considers the economic, technological, political and personal aspects of globalization, being inspired by the Human Development Index developed by the United Nations Development Programme. This indicator was calculated for just 62 countries (72 in 2007); some variables are taken into consideration two times (direct foreign investments, internet and phone traffic) and the variables are not adjusted for the geographical dimension. The smaller countries tend to hold the top positions because of the importance bestowed on the direct foreign investments, while the cultural globalization is not introduced.

Some other indicators aimed appeared to improve AT Kearney's indicator. Thus, Lockwood and Redoano (2005), designed the **CSGR[1] globalisation indicator**, in which they introduced a small set of new variables, but which is much different from AT Kearney's indicator in terms of components' adjusting, normalization and weighing. Caselli

[1] *Centre for the Study of Globalisation and Regionalisation.*

(2006) made a critical review of the instruments developed for the measurement of a complex phenomenon, such as globalization. After a brief presentation of the standard procedures that should be observed when such indicator is constructed and of the problems that appear when designing them, the author focuses on the most significant instruments measuring globalization that had been developed up to the moment of his study: A. T. Kearney/FOREIGN POLICY and CSGR indicator.

Martens and Zywietz (2004, 2006), starting from Zywietz (2003), proposed a **Modified Globalisation Index** (MGI) starting from AT Kearney's indicator which they improved technically. However, they started from a broad definition of globalization which includes environmental and military dimensions, thus reducing the economic component.

Heshmati (2006) didn't change the variables considered for the construction of A. T. Kearney's indicator, but added a complicated procedure of weighing them. Dreher (2005) expanded the number of variables referring to the personal contact and flow of information, introduced variables that measure the cultural convergence and reintroduced the measures of economic policy which Kearney used initially to measure the international economic integration.

The **New Globalization Index** (NGI) was developed by Vujakovic (2010) and it uses the analysis of the main components for a set of five new variables (and a total of 21 variables). The geographical distances between countries are introduced in the index through the variable for trade with the purpose to distinguish between globalization and regional integration. The final indicator measured the phenomenon of globalization for 70 countries and covered the period 1995-2005.

The **KOF indicator** was introduced by Axel Dreher in 2006, and then improved by Dreher, Gaston and Martens (2008). It covers the economic, social and political dimensions of globalization, being one of the most appreciated indices, with an impressive available statistical database.

Samimi, Lim and Buang (2012) reviewed the indices of globalization and came up with a synthesis, which eases the comparison between different indices of globalization. The authors consider that the indicators that include the criteria regarding the foreign capital, direct foreign investments, current commercial flow, trade and capital restrictions, culture, information and contact, political dimension, geographic adjustment and environment, are more precise than the indicators that don't include these criteria.

2. Brief critical presentation of the globalization indices

The results of the design and construction of indices measuring globalization can vary in line with the purpose and intentions of the researcher or of the economic policy decision makers. An analysis of the globalization indices may be difficult or incomplete because the used methodologies are often incompletely or unclearly presented and the access to the underlying data is partial or inexistent.

One of the criticisms to the manner in which such indices are constructed refers to the **participants** involved in this process: states, regions, individuals, companies etc. By selecting a particular indicator, the behaviour of some participants is implicitly privileged to the detriment of others. An example of indices that reflect the activity of global actors is OECD study on the activity of multinational companies (OECD 2005a and 2010a).

The economic theory needs a **conceptual clarification**. In practice, many times, the globalization indices or some of the secondary indices reflect rather different, although linked phenomena. As Scholte (2002) and Martens & Zywietz (2006) say, the globalization indices should be better differentiated from other economic indices that measure integration or the economic openness, the level of universalization orientation towards western economies.

Sometimes, the addition of supplemental dimensions may be deleterious to the significance of the globalization indices due to the **double recording** of the flows. As noticed by De Lombaerde and Lapadre (OECD, 2008), if the cultural or military dimensions are added by introducing the arm deals or exchange of cultural goods between nations, they use or replicate some records from the transactions of goods and services. Their suggestion is to disregard the arm deals or the exchange of cultural goods from the total trade of goods and services.

In the economic literature (De Lombaerde and Van Langenhove, 2006; Scholte, 2002) is observed the need to distinguish between **globalization as phenomenon and as process**. Conceptually, there is a consensus when we say that globalization is a long and complex process, but we must draw a difference from the perspective of the observer – we observe the process in time, while the particular state at a specific moment is given by a snapshot. When some indices of globalization are constructed, it is obvious that some logic components will refer to inputs, other to characteristics of the process or to outputs (such as the results and effects). Some authors (such as Heshmati, 2006), consider that the purpose of constructing a globalization indicator is to make use of its capacity of quantifying both the sources and impact of globalization, which would not include the characteristics and progress of the phenomenon. Brahmbatt (1998) suggested that the globalization indices should include the premises (such as the progressive reduction of the official barriers to the economic transactions between countries, the reduction of the cost of economic transactions) and the results (enhanced commercial and financial transactions, enhanced workforce migration or international convergence of prices).

One of the most often criticisms regards the use of an **excessive large number of variables** in the attempt to cover as many aspects of globalization as possible. It goes without saying that when an aggregate indicator is used, the idea is to simplify and synthesise a phenomenon, most times without expressing its complexity. The inclusion of a large number of variables draws other problems too: data availability for the countries covered by the study and therefore reduction of the sample (surveyed number of countries and period of time). On the other hand, a large number of variables may reduce the control on the quality of information and thus the veracity of the indicator. At the same time, the statistics are used with a rather large delay (about two years between the publication of the globalization indices and the surveyed period), which means that valuable time was lost since the globalization phenomenon evolves extremely rapidly.

Although most times the number of variables is impressively large, the **underground economy remains unregistered**, and many markets that contribute to globalization operate at the limit or outside the law (human trafficking, arms, drugs and animal smugglers, etc.)

Unavoidably, the construction of a composite indicator of globalization **needs weighing the secondary indices**. Various weighing procedures are employed based on methodological or theoretical considerations, but we cannot say that one is better than another one.

3. Reason for selecting KOF indicator for statistical analysis (definitions, methodology)

KOF indicators of globalization is one of the **most recent, updated and complete indices of globalization**. KOF indicator allows comparison between the different levels of globalization, for a large number of countries and for a period of almost 40 years. Using individually weighed data series, KOF indicator seems to provide the best image of the reality. The three dimensions (economic, political and social) are described by 24 variables.

The *economic globalization*, as described by the authors, is characterized by flows of goods, capital and services, but also by the information and perceptions that accompany the exchanges. We actually find here two dimensions, i.e. the actual economic flow and the trade and capital restrictions.

The *social globalization* includes three categories: personal contacts (gives information about the interaction between people living in different countries), flow of information (unlike the previous variables which were constructed to display the measurable interaction between people, this category includes variables that can identify the potential flow of ideas and images) and the cultural proximity (most difficult to quantify[2]).

The *political globalization* usually refers to the increase in number of power of some organizations, unions, which influence and govern the

[2] *Besides the variables included in the indicator, it also intended to use data on the number of English songs in the national list of music hits, or the number of Hollywood movies running in national cinema halls, but the authors of the indicator gave up this idea because of the lack of information in most countries included in the sample.*

world. The measure of this indicator is the number of embassies and high-level commissions in a particular country, the number of international organizations to which the country is affiliated, the number of UN peace missions in which the country was involved and the number of treaties signed between two or more states as of 1945.

Although this indicator can gives us an idea on globalization, it has some deficiencies, nevertheless. One disadvantage of KOF indicator is that the results are sometimes influenced by the extreme observations or by the missing data. The accuracy of some variables became obsolete, in the recent years, as the internet developed: information such as number on international letters or trade in books and newspapers has no longer the same importance. Measuring the foreign population can be difficult or at least inexact because many developed countries are confronted with the illegal immigration.

Unlike other indicators, KOF also attempts to include the cultural proximity, only that the cultural globalization refers to the dominance of US cultural products. As Rosendorf (2000) showed, the leading role of the USA in the socio-economic sphere is disputable.

4. KOF indicator – statistical analysis by country

KOF indicator (last version released on 16 March 2012) shows that the phenomenon of globalization is still on the rise, being supported by the economic and political globalization, while the social globalization is in standby.

In 2000-2009, Belgium was the country with the highest indicator of globalization, although it didn't rank on the top position in any category. In terms of economic globalization Luxemburg (2000-2005) leads, being followed by Singapore for 2006-2009. The highest values of social globalization display the lowest values within the three dimensions, but they all are above 91 points. Singapore was leader in this category in 2000-2006, followed by Cyprus in 2007-2009; the values were lower, however, for the latter 3-year period. The political globalization gathered the highest values overall; the leaders at this category were Austria (2000), United Kingdom (2001-2003), France (2004-2006) and Italy (2007-2009).

Table 1 – Top values of KOF indicator (including the secondary indices) for 2000-2009

	Economic globalization		Social globalization	
	Country	Score	Country	Score
2000	Luxemburg	97.64	Singapore	91.80
2001	Luxemburg	97.64	Singapore	92.06
2002	Luxemburg	97.17	Singapore	92.27
2003	Luxemburg	98.05	Singapore	92.83
2004	Luxemburg	98.88	Singapore	93.25
2005	Luxemburg	95.92	Singapore	92.63
2006	Singapore	95.81	Singapore	92.62
2007	Singapore	96.42	Cyprus	92.55
2008	Singapore	97.52	Cyprus	92.19
2009	Singapore	97.39	Cyprus	91.76
	Political globalization		**KOF indicator of globalization**	
	Country	**Score**	**Country**	**Score**
2000	Austria	97.28	Belgium	92.72
2001	United Kingdom	97.31	Belgium	92.38
2002	United Kingdom	97.31	Belgium	92.31
2003	United Kingdom	97.31	Belgium	92.25
2004	France	96.86	Belgium	92.17
2005	France	97.11	Belgium	91.96
2006	France	97.77	Belgium	92.14
2007	Italy	98.21	Belgium	92.78
2008	Italy	98.21	Belgium	92.84
2009	Italy	98.43	Belgium	92.76

Source: authors' calculation using KOF database, Swiss Economic Institute (available at http://globalization.kof.ethz.ch/, retrieved on 22 November 2012)

If we look at the minimal and maximal values of the KOF indicator for the entire available period (1970-2009), we may notice that the secondary indices peaked in 2004 (Luxemburg for economic globalization and Singapore for social globalization). The lowest values are characteristic to less developed countries, particularly in the 1970 and 1980 years.

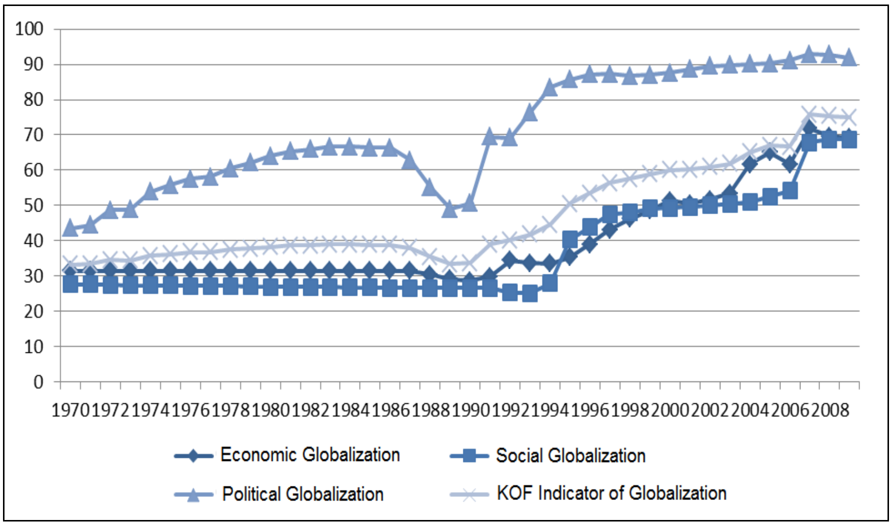
Table 2 – Minimal and maximal values of the KOF indicator (secondary indicators included) for 1970-2009

	Maximal value			Minimal value		
	Country	**Score**	**Year**	**Country**	**Score**	**Year**
Economic globalization	Luxemburg	98.87	2004	Rwanda	9.41	1972
Social globalization	Singapore	93.25	2004	Myanmar	5.68	1987
Political globalization	France	98.56	1995	Mayotte	1.00	2004
KOF indicator of globalization	Belgium	92.83	2008	Zimbabwe	30.54	1980

Source: authors' calculation using KOF database, Swiss Economic Institute (available at http://globalization.kof.ethz.ch/, retrieved on 22 November 2012)

The values calculated for Romania (1970-2009) display a constant trend (ranking between 25 and 40, except the political globalization component which displayed a particular evolution) until the beginning of the 1990 years. As of that moment, the values of the indicators started to increase somehow in a similar manner, the political component (again) displaying the highest values, after decreasing at the middle of the surveyed period.

Chart 1 – Values of KOF indicator calculated for Romania, 1970-2009



Source: authors' calculation using KOF database, Swiss Economic Institute (available at http://globalization.kof.ethz.ch/, retrieved on 22 November 2012)

If we analyse the ranking of Romania according to KOF indicator, for 2000-2009, we may notice that its position increased with the lapse of time. A considerable increase was noticed in 2007, when is observed a sharp ascension in the top (slower increase for the political component, but this ranking is the highest of all components, although the advancement was slower). KOF indicator is calculated for 208 countries, which means that Romania ranks within the top quarter of the classification, being a country open towards the exterior in all three domains included by the indicator.

Table 3 – Ranking of Romania according to KOF indicator for 2000-2009

Year	Economic globalization	Social globalization	Political globalization	KOF indicator of globalization
2005	58	75	21	45
2006	73	72	23	47
2007	50	46	20	33
2008	51	43	21	36
2009	51	41	24	34

Source: authors' calculation using KOF database, Swiss Economic Institute (available at http://globalization.kof.ethz.ch/, retrieved on 22 November 2012)

5. Concluding remarks

Although the phenomenon of globalization has been studied for a long time, it is still disputable whether it is good or bad to be on top or at the bottom of the classification. Some say that it is better to be on top because there is cultural diversity and access to people and goods worldwide. For other people, this is a bad thing because the national culture is lost and the country becomes homogenous.

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INTERNAL RATING – AN ACTIVE INSTRUMENT IN THE MANAGEMENT OF BANKING RISKS. CASE STUDY BCR

Gabriela Cornelia Piciu, PhD[*]

Abstract

This paper aims to clarify some aspects regarding the banking activity in general, of crediting, in particular, because it involves a risk by the very elements of anticipation underlying the decision of the banking specialists. For the bank it is very important to know this risk, to make an evaluation as close as possible to reality, and to reject or accept it in full awareness.

The contribution of the internal rating in terms of efficiency and stability of a bank is shown via a case study – the Romanian Commercial Bank. The internal rating used by BCR is an active instrument for making credit decisions it provides valuable indicators to he banking analysts that can be used to develop de risk management policies and the prudential measures for the balanced risk dispersion.

Given the fact that the credit rating contributes to the objective, professional analysis, the system must be continuously improved and developed by categories of clients and types of risk, so that the included criteria and the resulting conclusions are relevant.

Keywords: rating system, managing risk, monitoring the credit, analysis of the customers

JEL Classification: G11, G21

1. Introduction

The rating system of credits may be two dimensional, corroborating the results of the analysis of the customer's characteristics with those of the credit and it is based both on statistical comparison and on analysis and prognosis.

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The customer's characteristics are based on the analysis of the general aspects, the financial aspects, the position in the field of activity, the quality and stability of management and the strategy of business. The analysis of the credit's characteristics is based on the credit relationship history, the achievement of the terms of eligibility, the managing and monitoring the credit, the debt service, the source of repayment and the nature of the sides.

The credit rating is calculated for all the customers who benefit of credits and who are in the bank's portfolio, based on the annual accountant balance and on the other periodical accountant situations, as well as on the occasion of granting/reviewing credits.

2. Credit rating - instrument of risk management

As a functional instrument of risk management, the credit rating is actively used in underlying crediting decisions, because the determined rating underlies the approval or the rejection of credits request and further on the approval, the permanent monitoring of the relationship cost/efficiency/risk regarding each field of activity, each customer and even each product.

For the customers who are eligible for crediting, rating is associated with other criteria (the debt service, the level of currency profits) in order to establish the risk margin of the customer (RMC). This way, the rating has a direct influence on credit costs, taking into account that RMC represents a component of the rate of interest established for credits.

Throughout the mentioned criteria, the mark (rating) given to a customer has a high informative level and it represents the basis for establishing the limits of risk exposure for the big customers of the bank. Besides the operative function of decision instrument in the process of crediting, credit rating, analysed in its evolution on categories of customers, on economic branches and so on, offers valuable clues to bank analysts, and based on these they ground the management policies of risks and the caution measures for a balanced dispersion of it.

The purpose of the analyses based on credit rating is that of making difference between the risk levels from the loaning portfolio of the bank in order to: avoid the gathering of credits in the categories with a high risk;

determine a trend of a financial stand of customers so as to take the necessary measures early in order to avoid the deterioration of the quality of the loaning portfolio ; ensure the management of crediting risk and the appropriate protection of the bank and of the customers against the typical risks.

Thus, it was expected that a great number of financial institutions to start improving their own risk management systems by designing some internal patterns which could go far towards measuring and aggregation of risks in a shape integrated along the whole institution.

So, a relevant example in this direction is represented by the Romanian Commercial Bank, a dynamic and stable bank in the Romanian banking system, which created its own system of credit rating.

3. BCR - internal rating

From the point of view of BCR, the internal rating represents an efficient instrument for the management of risks, in this bank it has been existing for more than 10 years their own methodology of risk approaching in the crediting activity based on rating.

The initial system of credit rating was adapted to the new economic realities, based on the results and the conclusions drawn from practice and moreover, they resorted to the identification of some new domains of activity which lend themselves to an interpretation of risk management by using the rating method.

Through the complexity of the activities that it displays, BCR disposes of a complex frame of banking risks management, in which the rating system is applied, besides its crediting activity, which is its main activity and in other domains of activity:

- using the ratings assigned by the famous international agencies (country rating, bank rating) in their own analyses, which have as a purpose the establishing of the risk limits towards the partner-banks;
- using the method of internal rating in order to analyse the credit worthiness of the-reinsurance societies with whom BCR has business relationships and conferring risk limits towards these;
- Establishing risk limits regarding the maximal exposure of the bank towards its main customers, corporations and the judicial dispersion

of credit exposures on each domain of activity of the national economy.

The Romanian Commercial Bank has implemented and has been using since the year 2000 its own system of credit rating, which contributes to the objective and professional analysis of the customers of BCR. The system has been continuously improved and developed on categories of customers and types of risks, so that, the included criteria and the obtained conclusions could be relevant.

At present, BCR disposes of internal ratings for:

- Customers from the category of corporations,
- New-appeared customers (for whom there is no history of business),
- Natural persons and authorized natural persons.

For customers which are corporations, the methodology of BCR presents an appropriate detailed description on quantitative (quantifiable) and qualitative (unquantifiable) criteria.

In the category of quantifiable criteria (Table 1) there are taken into consideration:

- The evolution of the business turnover in real terms;
- Liquidity and solvency;
- Profitability;
- Debt degree;
- The value of export in the business turnover;
- Refund source.

Table 1: BCR's credit rating for corporate clients - quantifiable criteria

Nr. crt.	Financial Criteria	Val.	CR1		CR5
1.	Trend of turnover (in real terms)	0,10	Ascending the last 5 years		Decrease by more than 30%
2.	Current asset liquidity	0,06	high		Unfit

3.	Patrimonial solvency	0,07	high		insolvency
4.	Profitability (return on equity)	0,08	High and stable		Losses, the prospect of bankruptcy
5.	Indebtednes s	0,06	very good		Inadequate
6.	Share of exports in turnover	0,02	Over 50%		Less than 10%
7	Source of repayment	0,10	Cash flow from operation s		Liquidation of assets

Source: www.bcr.ro

For each of these quantitative criteria, employment levels are set by branch of activity which includes client, so finally score have a high degree of relevance in terms of the client's financial standing and function industry-specific.

In what regards the qualitative, non-financial criteria (Table 2), the analysis of BCR takes into consideration:

- the quality of the shareholder and management;
- the strategy, market conditions;
- the accuracy of the financial-accountant reports;
- received collaterals.

Table 2: BCR's credit rating for corporate clients – non-financial criteria

Nr. crt.	**Non-Financial Criteria**	**Val.**	**CR1**	**…**	**CR5**
1.	Quality shareholding	0,08	Domestic and international prestige		Quality confusing / dubious
2.	Management	0,1	Stability and experience high		Weak, frequent changes
3.	Eligibility conditions	0,09	For any type of loan		ineligible

4.	Strategy	0,08	Well defined and systematically carried		unclear
5.	Market conditions	0,09	Growing		Without development opportunities
6.	Accuracy of the financial-accountant reports	0,03	Audited by international firms		Unaudited unavailable
7.	*Received collaterals*	0,04	Strong guarantees		Guarantees low market value, with the trend of deterioration

Source: www.bcr.ro

For each one of these quantitative criteria, the levels of classifications are established depending on the field of activity in which the customer takes part, so that, in the end, the obtained score can have a high degree of relevance in what regards the customer's financial standing and depending on the characteristics of each industry.

In order to establish the credit rating, with each financial and non-financial criterion it is associated a level of appraisal from 1 (the best) to 5 (the weakest) and it is balanced with the specific weight attributed to each appraisal criterion. The balanced average of the 14 criteria represents the credit rating of each loan.

A distinct objective of risk management in BCR in the year 2007 was the fulfilment in the shortest time of a database, regarding the evaluation of the possibility of non-payment associated with each debtor and of the additional risk factors, as well as the loss generated by non-payment and the exposure to non-payment. That is why, the credit rating which exists in the bank's records on a previous period of about 3 years, for each customer from the portfolio, has been really useful for the application of the principles from Basel III, based on a standardized approach of risks in the form of rating systems.

At the same time as the introduction in the portfolio of products of BCR of the mortgage credit, it was created a rating system intended for the analysis made to give this type of credit. It is based on the greatest part of the criteria used for the rating of natural persons, with some new criteria adjusted to the characteristic of the mortgage credit.

This is a proof of flexibility and adaptability, a proof offered by BCR on the track of identifying market needs, creating the products which correspond to these needs, at the same time adapting the instruments of risk management that the bank takes through its new promoted products.

A distinct form of an analysis type rating applied in BCR is that of determining the limits of risk exposure on domains of activity, used in order to avoid the gathering of credits in certain domains of activity with a higher risk. This is made because the criteria used in establishing the final score of each domain of activity take into account: the remaining credit, the unpaid interests, the payment arrears (budget, suppliers), the importance of the private domain, the medium degree of supply, the loss recorded by the customers from that domain, the contribution of the domains to the making of PIB and to the accomplishment of export.

For a long period of time, BCR has been elaborating and implementing a complex methodology of analysis and quantification of risks towards the societies of insurance-reinsurance with which it gets into business relationships.

Based on its own rating system, BCR determines the limits of risk exposure towards the societies of insurance-reinsurance, limits that are usually established for a year, but which are permanently revised and they can be modified as many times as necessary.

Just like in the case of the other customers – corporations, rating is based on the financial and non-financial indicators, with a special emphasis on the position in its domain of activity, the quality of management, the strategy and the caution policies which are characteristic to the insurance societies.

In what regards the non-financial indicators, there are taken into account:

- the structure of shareholders;
- the level and the structure of the corporate funds;

- the network of branch offices and the market share;
- Giving up risks to external reinsurance and the quality of reinsures.

The financial indicators taken into consideration refer to:

- liquidity coefficient;
- solvability degree;
- technical reserves obtained;
- damage rate;
- profitability rate; indebtedness degree;
- Other relevant indicators, mentioned in the norms of the Commission of Insurance Surveillance.

4. Results and contribution to existing knowledge

The research has shown that the credit rating system of a bank can also be bi-dimensional (the case of BCR), corroborating the results of client characteristics analysis with the results of credit analysis, relying both on statistic comparisons, and on analysis and prognosis.

Client characteristics result from the analysis of the general financial aspects, of the position in the field of activity, of the quality and stability of the management and of business strategy.

Credit analysis includes the history of past credits, fulfilment of the eligibility criteria, credit administration and monitoring, debt service, source of reimbursement and type of collaterals.

The credit rating is calculated for all clients of credits included in the portfolio of the bank, on the basis of the annual accounting balance and of other periodical accounting documents, and when the credits are reviewed.

As functional instrument for risk management, the credit rating is actively used to decide whether to accept or reject the credit application, to monitor permanently the cost/efficiency/risk relation of each branch of activity, each client and even each product.

For the clients who are eligible for crediting, the rating is corroborated with other criteria (debt service, hard currency cashing) in order to determine the client risk margin (CRM). Thus, the rating has a direct influence on the cost of the credit, since CRM is a component of the interest rate for the credit.

By the included criteria, the rating assigned to a client has a high informative content and it is used to determine the limits of risk exposure for the big clients of the bank.

Besides the operative function of decision-making instrument within the process of credit granting, the credit rating, analysed by category of clients, economic branches, etc., provides valuable hints to the bank analysts, which enable developing the risk management policies and the prudential measures for the balanced dispersion of the risk.

5. Conclusions

The rating system used by BCR is based on a series of coefficients of change in an equivalent risk of securing the exposures which appear both from direct risks and from indirect risks of the bank towers the insurance-reinsurance societies. This professional approach of managing risks under the standardized form of internal rating must be watched in the general context of the management system developed within BCR and it proves the bank's concern to consolidate its position within the banking system and to maintain its performance indicators at a high level, by eliminating any potential sources of loss, thus protecting the customer's interests.

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THE INSURANCE MARKET OF THE REPUBLIC OF MOLDOVA IN TERMS OF INVESTMENT POTENTIAL

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Cristina UNGUR**

Abstract

The financial market of the Republic of Moldova has been characterized by a high degree of uncertainty during the last years. The political instability had its consequences causing disturbances, especially on the bank market. At the same time, the global financial crisis has had a direct impact on the national financial market as well, reducing thus the investment potential in the bank and non-bank financial sector, especially of the foreign investors. Notwithstanding the insurance market of the Republic of Moldova has registered a growth during this period. The paper presents an analysis of the insurance market in terms of its investment potential and tries to explain the behavior of the insurance products' consumers in the conditions of the actual financial and economic crisis.

Keywords: financial market, life and non-life insurance, financial crisis, bank sector, investment potential

JEL Classification: D53, E22, G016, G22, G23

The last years show major fluctuations in the global economy resulting in situations of uncertainty on economic segments of all countries of the world. Since 2008 the global economy has been marked by major problems in the financial market of the United States which occurred in mid-2007. These problems have spread rapidly around the

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world and since September 2008 have been transformed into an international financial crisis. Only since 2010 the world economy entered a recovery phase, but at a very slow pace. Each country has traveled its path for a return to normal economic operation. Some countries have suffered more serious consequences than others, but the recovery was full of risks for each.

2012 was again a fairly difficult year. Economies continued to feel the consequences of the most severe financial and economic crisis following World War II represented by: high unemployment, high inflation rates, fiscal consolidation, etc. Regressive trends in the global economy in recent years have found themselves reflected in the national economies. Moldova is no exception, which has suffered from the financial crisis, especially on the public budget and the financial market.

In the economic system of the Republic of Moldova the most powerful is banking segment. Although it cannot be compared with the performance of banking systems of European countries and the U.S., however, for our country is the most advanced sector of the financial market. Certain characteristics of the banking sector in Moldova, the crisis has not led to a taint system and resisted those negative effects marked by the developed banking systems. However, the particularity of the Moldovan banking system is that it is the main and almost the only source of funding. Unlike developed countries where the main source of funding is the stock market.

More and more financial experts emphasize the importance and necessity of regulating banking and insurance[1]. The significance of the insurance industry in the national economy is often neglected. In Moldova, the industry is left in the shadows compared to the banking industry, but insurance contribution to economic growth and social welfare is recorded by many states. Insurance and financial stability contribute to increased risk taking financial and otherwise. These flows can generate reliable and substantial life insurance. Insurance companies can create a competitive banking system in the process of financial intermediation. They are organized so as to gain money from

[1] *Adriana Rodica NASTASE „Asigurările şi criza financiară", Buletin AGIR nr.3/2011, July-September, pages 134-140*

insurance premiums paid by customers which means that the money collected must find where to be invested. Therefore, insurance companies can become sources of capital for banks on a very long term for the capital market or other instruments.

The insurance sector in Moldova outlines an investment potential that can be exploited so that the effect would be felt by the population, the public budget and the economy in general.

In countries with a tradition in the insurance field, there are used quantitative and qualitative indicators for the development level assessment of the insurance industry analysis. Some of these have been applied in this study to reflect the "potential" accumulated in the insurance sector in Moldova.

“Penetration” in the economy is a synthetic indicator which shows the contribution of the insurance sector in GDP creation and is calculated as the ratio between the amount of direct gross premiums and GDP. “Density” is expressed as the ratio of total direct gross premiums receivable by them and the total population of that country, thus expressing the average premium per capita. [2]

Table 1 The size of the insurance market of Moldova in quantitative parameters

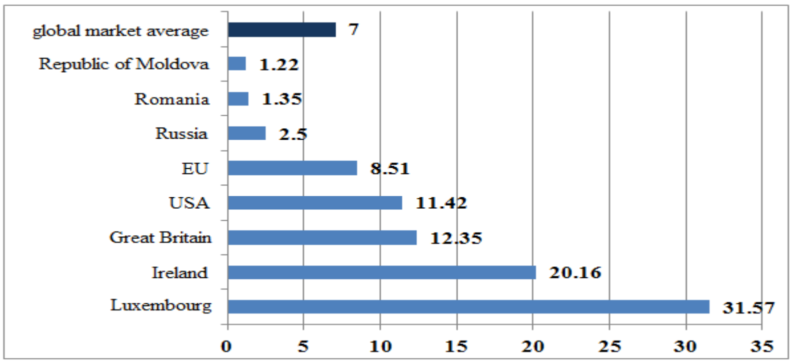
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Gross written premiums, mil. lei	724.2	837.2	816.5	914.7	1006.3	1088.1
GDP, mil lei	53429.5	62921.5	60429.8	71885.4	82 174	87 847
Rate / growth rate of GDP,%	-	117.7	96.0	118.9	114.3	99.2
Population, mil. resident	3581	3573	3267	3,563	3559	3560
Penetration,%	1.36	1.33	1.35	1.27	1.22	1.24
Density, lei	202.2	234.3	249.9	256.7	282.7	305.7

Source: developed by the authors based on data NCFM for 2007 - 2012

From the table we see that in Moldova the insurance share in GDP is quite insignificant. This indicator shows a slight decrease in the last years but more importantly, the overall insurance contribution to GDP is insignificant in Moldova.

This is worrying given the major role of the insurance industry in the sustainable development of a modern economy. For comparison we mention that, according to OECD statistics for 2011, the penetration of insurance in GDP in other countries is much higher. The first place in this top is held by Luxembourg, a very small state which is not precluded from having the highest insurance penetration in GDP, namely 31.57%, followed by Ireland with 20.16% and the UK with more than 12%. In the U.S., where the insurance industry is one of the strongest in the world, the indicator is 11.42%.

Figure 1 Insurance penetration degree in GDP



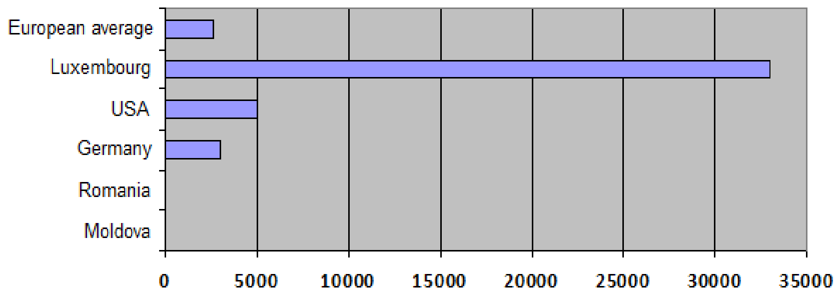
Source: Authors' calculations based on OECD data, 2011

Obviously Moldova remains far behind with a penetration of only 1.24%.

Insurance density is an indicator that reflects the costs incurred for insurance products per capita and shows how the risks of citizens are managed effectively.

In a common interpretation we can say that every citizen in the Republic of Moldova is entitled to about 250 lei, or 20 USD in gross premiums paid for the insurance, while in Luxembourg this figure reaches the value of 33 thousand USD, in the U.S. - 5000 USD, 3000 USD in Germany, and in Romania - 60 USD / capita. The overall average for Europe in premiums per capita, according to the CEA (see figure below) is 1879 euro in 2010 (or 2615 USD).

Figure 2 Gross written premiums per capita



Source: developed by the authors based on data from OECD Yearbook 2011 and CEA

Is an obvious discrepancy between gross written premiums relating to each citizen in our country compared to the countries that have a developed insurance industry. Just compared to the European average this indicator in Moldova is 124 times smaller.

The positive development of the insurance market in Moldova over the last years becomes even more apparent through the constantly increasing volume of premiums collected. In 2012 was also reached the historical record in this regard by exceeding a billion lei since raising premiums. Thus, the national insurance market was not significantly affected by the crises that have occurred worldwide and has brought major discrepancies for the main indicators of activity.

Table 2 Insurance sector developments

	2007	2008	2009	2010	2011	2012
Gross written premiums, mil. lei	724.2	837.2	816.5	914.7	1006.3	1088.1
Benefits & claims paid, mil. lei	235.3	273.8	361.2	322.7	348.4	430.5
Net assets, mil. lei	364.9	656.4	812.7	1081.7	1192.4	1241.8
Capital, mil. lei	207.7	323.1	388.5	420.1	515.2	556.7

Source: developed by authors based on data NCFM

The evolution of the insurance sector in Moldova has major fluctuations during the difficult years from a financial standpoint. A slight decrease in gross written premiums acquired during 2009. However, the insurance sector in Moldova recorded dynamic growth rates over the last years. In the context of implementation of reforms in the insurance sector the income from received premiums insurance / reinsurance increased.

However, there are opinions that the difficult economic situation influenced the Moldovan insurance market, given that it is actively connected to other areas such as construction, leasing or transporting. However, at the end of 2010 we had an optimistic result, concluding the insurance market with an increase of 12 percent, and over the past two years growth was evident.

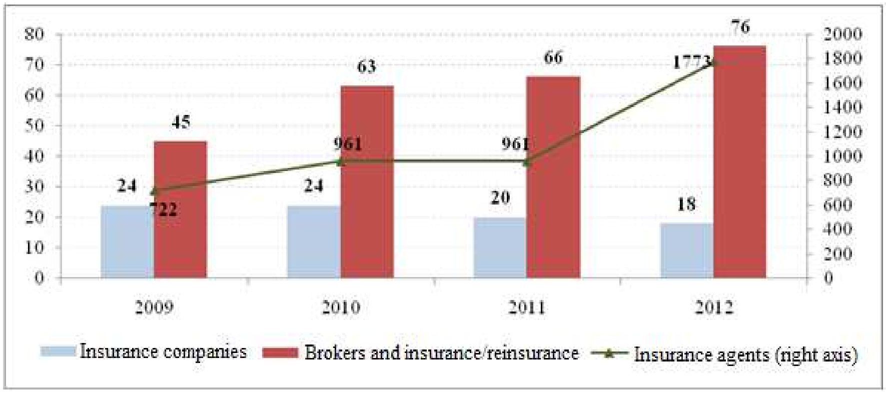
Steady growth of net assets shows that the insurance sector in Moldova is quite profitable, because according to the balance sheets of insurance companies it was recorded an increase in net assets due to higher net income of the reporting period and to the increased long-term assets. This shows the profitability and safety of long-term insurance business based in the country.

Another indicator that can quantitatively assess the state of the insurance market is the number of participants of the insurance market. In Moldova this indicator shows significant fluctuations due to changes in the regulatory framework, in particular the requirements on minimum capital and reserve requirements.

Thus, if market-wide aggregates were not affected by the recession, at the level of insurance companies, were large fluctuations.

Over the years the number of insurance companies operating in the insurance market decreased significantly (Figure 3). According to data provided by the NCFM, in Moldova there are 20 currently working insurance companies and 66 insurance and reinsurance brokers.

Figure 3 Evolution of professional participants on the insurance market



Source: NCFM, annual reports for 2009 -2011

From Figure 3 it appears that by adopting new business conditions established by the Law on Insurance[2], the number of insurance companies is held constant. Following the imposition of new game rules the number of companies began to decrease, largely due to non-provision of a capital increase.

However, the new law allowed the establishment of new insurance and therefore the insurance portfolio diversification. This has led to the necessity of intermediaries in the insurance market. Thus, in 2009 the first insurance/reinsurance brokers appeared whose number has increased dramatically over the last years, reaching 76, the number of insurance agents has also increased from 722 recorded in 2009 to 1773 in 2012.

The aggregated structure of the insurance portfolio of companies in Moldova shows predominance of mandatory insurance. Population appeal to insurance companies only where it is required by law, and this would mean that there is potential for major development in the field of voluntary insurance, especially life ones.

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[2] *Low of Insurance No. 407-XVI from 21.12.2006. Oficial Monitor No.47-49/213 from 06.04.2007*

Table 2 Insurance portfolio of insurance companies from the Republic of Moldova during 2010-2012

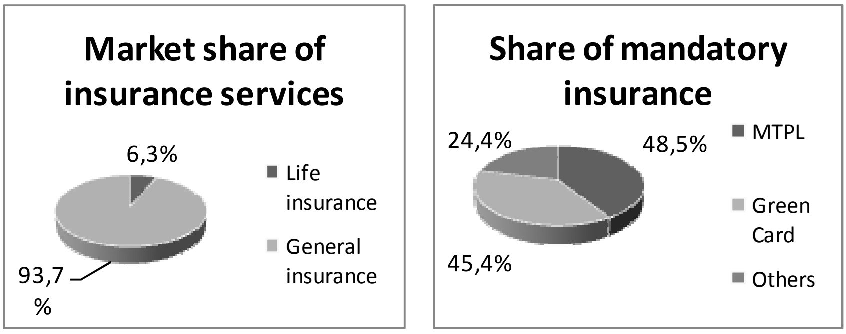
Class of Insurance	Indemnification and insurance claims on insurance classes					
	2010		2011		2012	
	mln lei	quota, %	mln lei	quota, %	mln lei	quota, %
I. General Insurance, inclusively	*860.90*	*94.12*	*940.80*	*93.49*	*1 020.70*	*93.70*
- Casco	176.48	19.29	192.62	19.14	192.63	17.68
- MTPL	452.00	49.41	512.51	50.93	555.37	50.99
- Goods and health insurance	232.42	25.41	235.67	23.42	272.70	25.04
II. Life Insurance	*53.82*	*5.88*	*65.52*	*6.51*	*68.57*	*6.30*
Total	**914.72**	**100**	**1006.32**	**100**	**1089.27**	**100**

Source: developed by the authors and based on the NCFM Report 2012

It is obvious that the most popular insurance is mandatory insurance especially MTPL (Motor Third Party Liability) with a share of about 51% of total premiums. However, this type of insurance has the largest share in most Moldovan companies. The smallest share is held by security people that are voluntary and include life insurance, health or accident insurance.

From the aggregated structure of insurance portfolio for 2012 it is clear that 93.7% of insurance policies are included under general insurance. This enormous rate is due to MTPL insurance that is mandatory under the law and fall under the category of general insurance.

Figure 4 Aggregated structure for insurance portfolio in 2012



Source: developed by the authors based on data and NCFM

European statistics and insurance services divide the world into two categories: life insurance and non-life insurance. Thus the CEA statistics indicates that in the developed European states the insurance business is based mostly on life insurance. As mentioned above, the average gross written premiums per capita in Europe is 1879 euro, of which 1147 euro (or 61%) is life insurance. In Moldova, only 6.3% of the total portfolio insurance lies with life insurance.

The same limited request is also characteristic to health insurance in our country. This type of policies have a share not exceeding 5% of the market of insurance services and therefore there is a need to develop this segment. The need comes from discontent against mandatory health insurance that does not provide opportunities for financial coverage for all types of medical services.

The life insurance field for Moldova is at an early stage not only because of the lack of a culture of providing the population that does not know how to manage their risks. Another reason would be that trust in the state as insurer of last resort still remained in the public consciousness. Also nor the retirement system is reformed so that the state diversifies the risks in providing pension or social security for some population groups. It monopolized the right to manage completely the collected money without giving away some of its bonds, though often there were failures. Another reason is that life insurance requires large investments and entails major risks, thus companies do not engage easily in this sector, which is a strategic one. Following the model of developed countries we can realize that life insurance will become increasingly popular in our country, so this will be a very attractive sector for investment.

The insurance industry is a complex area but extremely necessary for a modern economy and this sector is well prepared for the financial challenges because they do not contain systemic risk. At the same time they offer different coverage possibilities for several financial risks, commercial and social, but also accumulate a significant investment potential.

Analyzing the key indicators of the insurance market in Moldova, we find that it indicates steady growth rates for the past 10 years. The legislative changes have helped to strengthen the sector and to establish tough work criteria for participants which filtered unreliable companies. There have also been established clear rules, thus increasing the confidence of foreign investors. Another extremely important change to promote our image is political stability. After the tedious parliamentary elections from 2009 and the political crisis due to the failure to elect the President, which resulted in a successful finale, the country has come to establish a certain European vector. Thus, the investors across Europe have obtained the confidence that they can invest in Moldova. All these factors contribute to the development of the insurance market's investment potential.

On the other hand, there are sectors underdeveloped in the portfolio of local insurance companies which means that there is an untapped potential in this segment. Considering that only two of the 20 companies in the country provide services for life insurance, it would be a very interesting area for investment because it provides long-term stability and therefore is a safe investment.

A few years ago, on the Moldavian banking market there were given highly favorable terms for deposits. Banks needed liquidity that increased their loan portfolios, therefore raising capital by paying interest rates on deposits in nearly 20% for MDL and 6-8% for foreign currency. Back then bank deposits were the most advantageous way to invest money and to secure an income in the future. In recent years the situation has changed on the banking market. The interest rates have dropped significantly, being only of 9-10% for MDL and of 4-6% for foreign currency. This shows that the interest of people to invest in bank deposits and thus decreases the investment alternative becomes insurance, especially voluntary ones. Thus lately insurance premiums of life insurance increase which is in itself an indicator of the stability of long-term insurance companies, given that the minimum term for life insurance is for 10 years. Therefore investors who will invest in insurance, especially life, will be provided through annual premiums paid by policyholders during long periods of time. Obviously there are risks of occurrence of the insured, there is a need to create reserves, to increase statutory capital, but it is much smaller than the benefits.

So, on the insurance market in Moldova there are major investment opportunities due to the following factors: favorable conditions for a new or insurance intermediary insurance company; acceptable competitive environment, the positive dynamics of foreign investment on national insurance market, legislative framework adjusted to European standards; development of infrastructure, the use of an automated information system in the MTPL and the Green Card; the improvement of strategies in terms of transparency, management of risk and structure of provided facilities; restoring the trust of civil society in the insurance system.

The development of the insurance industry has a great future in the Republic of Moldova and the interest of society towards this segment is becoming increasingly evident. But to reach the maturity of the insurance market, we need many reforms, significant investments and persistent competition in this area.

Profound and accelerated changes in the insurance market, due to the promoted reforms, lead to the financial strengthening of the insurance institutions and to providing services in accordance with the highest standards of quality and accessibility for the population.

Recently it was managed to adjust the legislative framework to the Community acquis and international practices, was developed infrastructure operation and were offered insurance products as the needs of society. The changes in the economic and financial environment have led to a new approach aimed at transparency, consumer protection, financial education, and also to the high professional standards in the insurance business. New regulations in the insurance field confirm the qualitative evolution and growth in the insurance market positions and, of course, encourage innovation and technology development in this field.

The factors that conditions the current situation of the population are low income, low insurance culture in society, people learning to rely on state support in difficult situations, and insufficient legal framework that would foster the development of quality insurance.

The experience of economic and financial crisis has shown that the economic models used for risk reduction have not worked effectively. Insurers need to manage risks and maintain an adequate level of resources to cope with various risks and to quantify future financial position in a broad sense. For these reasons, our main task is to create an area resistant to any future crisis.

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ASPECTS REGARDING THE SOCIO-ECONOMIC DETERMINISM – ANALYSIS AT THE EUROPEAN UNION LEVEL

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Abstract

Theoretically, the *determinism* represents a concept according to which the phenomena are generated by chains of causes and effects by conditionings and laws, by the necessary and repetitive interactions. As regards *socio-economic determinism,* it can be said that it shows the importance of the social factor in determining the economic development. Usually, paradoxically, although it is the key element in deciphering economic behaviour, the social factor, by its main representative - the man, is almost always excluded from analyses which regard the elements that contribute to the determination of economic development at national, regional or global level. For this reason, we consider necessary a shift in current paradigms towards the social factor, at the same time, positioning social policy the centre of public policies.

Today, in a highly globalized world, when the powerful turbulences are observed on the international markets, social policies development is conducted under the pressure of new constraints, with obvious implications on all aspects of economic, political and social life. Although European Union is the promoter of the welfare state values, it does not focus enough the attention to the theoretical and practical aspects related to the reform of social policies, to the development of human capital and to the improvement of social cohesion in order to meet the current challenges of the globalized world. Thus, this article brings as novelty a series of arguments on the role

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and the place that the social factor should occupy in the economic sphere, it not being at this time an economic determinant.

Keywords: socio-economic determinism, social policies, human capital, social cohesion

JEL: J24, J08, O15, I38, H12

1. Introduction

The current world is experiencing a period of deep transformation after passing through a period of severe recession marked by financial turbulences, by the decline of the industrial production and of the world trade, by the continuous deterioration of the labour market and of the social fundaments. Thus, in the social field, one may notice a spectacular increase of the unemployment rate, of poverty, the deterioration of the working conditions, labour force migration and other adverse phenomena. Although worldwide there are organisations which debate and try to find solutions to the social problems, they still remain stringent and extremely difficult to solve. Among these problems are the poverty and the effects of the climate changes on the life conditions of the people, the inequitable globalization, the indecent working conditions, a trade system which is unfavourable to the developing countries, an international financial system yet insufficiently encouraging for the investors and the labour force, discrimination of the immigrants in the destination countries and the inexistence of a coherent international democratic system.

There are extremely few means to control and alleviate the social problems (and not only) at worldwide, regional and national levels, which requires a systematic, properly structured vision, which to take into account all the components of the economic, social, political and legislative life.

In this globalized, continuously changing world, with many problems, the economic, political and social theories, and the policies and systems grow in diversity, displaying resemblances and dissimilarities, by divergences and convergences, by complementarities and integrations of the national economies, of the explanative-interpretative approaches.

The definition and description of these theories helps understanding better the structure of the economies, the way they operate the harmonization of their evolutions, the institutional construction, at the European Union level included. The change of the socio-economic, political, institutional, etc. realities determined the renewal of these theories.

Under these circumstances, the future of the European Union can be questioned. Its development is submitted to new constraints and complications, with obvious implications on the member states and on the other countries as well.

As it is known, the European Union is a supranational economic community, with its own system of governance which advances specific concepts, paradigms, institutions, mechanisms and procedures not observed in other international organisations. The process of European integration, by the theories and concepts formulated about it, reflects the economic, social and politic interests of the European Union and of its institutions. The clarification of the theories, concepts and paradigms that concern the process of European integration, such as European convergence and governance and its determinism, may contribute to a better understanding of it.

2. Theoretical aspects on the socio-economic determinism

Theoretically, *determinism* is a conception according to which the phenomena are generated by sequences of causes and effects, by conditionings and laws, by necessary and repetitive interactions. Actually, the concept of determinism is seen in opposition to the concept of *freedom*.

The social *determinism* sets the framework in which society acts or reacts to the stimuli that make it adhere to rules imposed by the society. The social determinism reveals the importance of the social interactions and constructions on the individual behaviour.

According to A.L. Bradford (1929), the term of "*social determinism* is a notion rather unfitted to the absolute conditioning of the human character by the aggregate social and biological influences. The term suggests a philosophy or discipline that probably doesn't exist, at least as ideational entity." However, he notices that "the social organisms operate *a priori* in influencing the generations yet to be born, and *a posteriori* by inducing environmental changes, which is enough reason to use the term of *social determinism* for this universal process."

Generally, the vision on the social determinism is at the micro-detail, or microeconomic level, showing the influence of the social constructions or realities on the individual behaviour. For a broader, macroeconomic analysis, we should analyse the social constructions and realities in the aggregate behaviour within the society and the implications of the conceptual and practice changes from the social field on the economic field. The latter is actually the approach that we will use in this paper, which is a novelty in the debates of the economic theory.

Another nuance of the determinism, or better said, of the *institutional determinism*, is the *determinism or path dependency* (Paul David, 2000), which, although doesn't has a direct connection with the economic and political sciences, is applicable to the institutional construction within the European Union. This determinism claims the importance of the initial choice in the evolution of a process or phenomenon, the current situation depending on the past decisions. The theory may be veridical because we may notice that the initial design of the European organisms had and still has a major importance on the current manner of decision-making and institutional behaviour.

On the other hand, in the new member states, within the process of accession to the European Union, the path dependency had a lower influence compared to the international institutional determinism, to the European determinism included, outlining the policies and institutional realities from those countries through the conditionalities imposed in exchange for the economic support.

Regarding the change of the socio-economic environment and of the related concepts, several internal and external factors and forces, acting solely or in conjunction, create new pressures and reciprocal conditionings.

In our opinion, the *socio-economic determinism* reveals the importance of the social factor for the economic evolution. Actually, the socio-economic determinism can be seen from the perspective of the institutionalism, functionalism, intergovernmentalism and federalism of the European Union which, through the measures it adopted (including those aiming to reduce the budget deficit and the public debt), constrained and shaped the evolution of the social policies and the labour market policies; on the other hand, this large set of measures with direct or indirect impact on the social policies produced effects of these policies at the economic level.

An interesting perspective on the socio-economic determinism can be obtained by analysing the countries from the North-American continent and those from the European continent. While in the North-American continent, the social problems are rather a task of the citizens, in Europe the states consider that the social problems should be part of the public policies, because a good solution to these problems leads to social progress. Nevertheless, paradoxically, the concern for labour and the establishment of an economic foundation for job creation, solution proposed by the North-American countries, seems to be a more efficient solution than the European one, which is rather declarative and formal. Actually, the active public solutions (North-American vision) and not those reactive (*post factum*) (European vision), can help the citizens make full use of their qualities; under the conditions of a high unemployment rate and of increasing social problems, only the efficient stimulation of the economic environment and of the private initiative may alleviate the tensions within the social structure and decrease the budget burden of the socially assisted people.

Within the current context, on the background of the global economic and financial crisis, both the countries from the North-American continent and those from the European continent display a strong feeling of aversion towards the public policies of social protection, focusing on the reduction of the fiscal-budget deficit, while paying less attention to the protection of the citizens from the dramatic effects of the crisis.

As it is known, the traditional way of economic growth relies on two factors: work and capital. The "bundle" of current crises has shown that there are other factors too that have not been accounted for. For instance, such an example is the human capital, strongly affected by the austerity measures enforced so far, which didn't produce economic growth or at least didn't limit the effects of the crises, but simply aggravated the macroeconomic misbalances, particularly to the detriment of the poor population.

Formally, the population is the focus of all social policies and of the labour market policies. As far as the population is the subject of education and professional training, we may speak of human capital, of its quality and less of it size, depending on the proper functioning of an economy. Of course, the proposal of ambitious quantitative targets for higher employment rates, lower unemployment rates, less poverty, reorganisation of the pensions system, improvement of the health care system etc., can be a starting point for the improvement of the qualitative social parameters; however, this is not a sufficient condition, just a necessary condition.

Socio-economic determinism – theoretical and practical analysis of the European Union

Analysing the socio-economic determinism within the European Union, we may notice that the concrete form of this concept displays an excessive structuralism determined by a huge volume of extremely ambitious target proposals, however with no functional perspective that may allow the member state to accomplish these targets; on the other hand, the natural consequences of the crisis reduced the budget possibilities to implement the social policies required for the harmonious development of the European Union.

As it is known, the role of the social policies is to identify, understand and transpose the needs of the population in a practical form, which to improve the general welfare, support the development of the human capital, improve the employment rate and implement an efficient formula of social cohesion, as intended by the EU programs and strategies.

Hence, it is extremely important to analyse the social component of the economic and financial crisis, which should be observed, highlighted and stimulated both in policies and in practice, so as to find the correct solutions to solve this situation and to control the social effects of the global crisis.

The control of these effects should not be limited to some directions such as: lower unemployment rate, labour protection, higher level of professional conversion of the people able to work, higher retirement age, more demanding eligibility criteria for social aids etc., but should consider a broader range of social aspects. For instance, the public policies design ignores the major demographic deficit within the European Union.

Population ageing is one of the main problems of Europe, and given the conditions of the crisis, many of the fiscal-budgetary constraints limited the access of the old population to incomes that may provide a decent standard of living. Furthermore, the European and national strategies do not include mechanisms that may attract the migrating population, to maintain and stimulate the local population to build their future in the countries of origin. The process of interregional migration within Europe may be beneficial if know-how and income flows occur between the more developed and less developed regions of Europe. In time, this might homogenize the standard of living of the Europeans, and the immigration of the young, properly trained population would no longer be such unpleasant problem for the host countries and for the origin country. The reality shows, however, that migration is many times irreversible (International Organization for Migration, 2008), or least, that it is long (Alvarez-Plata, Brücker and Siliverstovs, 2003); because of this, there is no important transfer of knowledge and the remittances from labour are not a sufficient basis for the sustainable growth of the standard of living in the country of origin, which happens sometimes for a very brief period, particularly because of the higher consumption. Knowing that migration is extremely sensitive to the changes in the GDP and in the GDP per capita, we may consider that the migration of population (particularly of the labour force) will increase with the gap of the GDP per capita between the countries of destination and the countries of origin.

Thus, we should not overlook that the human capital factor, particularly that which is active on the labour market, should hold an important place in the economic calculations, generating added value; thus, the European Union countries, taking into account their structural vulnerabilities, will bear a lower cost of the current crisis. Furthermore, although the human capital was in the focus of the austerity policies, it is extremely difficult to recover it on the labour market, which presumes high costs and longer cycles of “regeneration”.

Within the European Union, and not only, the human factor, which is formed within the family, school and church, is a determinant of the institutional changes and development. The values and norms underlying the development of the human factor contribute to the construction and expansion of the social networks, to the strengthening or weakening of the social cohesion. Hence, the social cohesion is one of the many European political objectives, and the form of manifestation of the human capital should be one of the major basics of the European Union.

In the vision of the European strategies (Europe 2020 Strategy, particularly), the growth that favours social inclusion presumes the provision of access and opportunities to life-long education and measures to control or reduce poverty. Although they are designed in an integrated manner, the objectives of the European strategies (such as the objectives regarding education, research and development, labour force employment, poverty) seem difficult to accomplish if, both within the European Union and within the member states, the political will to fulfil these strategies as much as possible and synergistically, lacks. In the absence of such strategy, the solutions and any European state that intends to design its development (an efficient social system included), if they work, will be accomplished only partially and on the short term.

3. Conclusions

The concept of *social determinism* is treated by the literature rather at the microeconomic level, the social aspects influencing the individual behaviour. Hence, this paper displays rather a macroeconomic approach, considering the social factors, both at the individual and aggregate level, at the society level, as main determinant of the economic evolution.

Generally, on the background of the global economic and financial crisis, the *human capital* factor is strongly affected by the austerity policies; it is difficult to be reintegrated on the labour market, presuming large costs and long periods of training and reintegration. Within the current context, the austerity policies affect mainly the European Union, which is also affected by an important demographic deficit. The demographic deficit, although determined and acknowledged as fundamental problem that influences the design of the public European policies, and the economic evolution, is a fact that is not given the proper consideration.

In the European Union, the design of ambitious packages of European directions, strategies and policies is not a solution for the actual reality lived by the European citizens, because many of them lack the instrument for national implementation, or it is inadequate; many times it is not an original vision, a personal pattern of development. Furthermore, the political will to materialise the European social and labour market strategies often is just declarative, the liberty of the national “original path towards development” being seen as “offense” to the synergic, common development. At the same time, there is no coaction between these policies and strategies at the level of all member states, or at least in a significant part of them, so that the local benefits of the successful implementation are felt by the other member states too.

The European Union will thus have to intensify the efforts to use the labour force potential, the training potential, to support the synergic development of the human capital so as to cope with the challenges brought forward by the increasing world competition and ageing of the European population.

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SOVEREIGN INVESTMENT FUNDS, OPPORTUNITY WITHIN THE CONTEXT OF THE GLOBAL ECONOMIC CRISIS

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Abstract

Emergent countries' governments which have at their disposal huge amounts of money from external balances of trade strongly in excess became foreground investors, influential players on the financial markets by means of sovereign funds, often with political component. The economic crisis triggered in 2008 made the sovereign investment funds to adopt an active position in the financial markets, contributing through their massive interventions in the European and American banks, to the rescue of world economy, consolidating their position within the global financial sector. The consequences of the sovereign investment funds' strengthening are both economic and political, influencing the pregnant change within the world power ratios in the new multi-polar world, from political and military point of view, with significant growth of interdependence of national economies.

Keywords: emergent countries, financial markets, economic crisis, sovereign funds, world economy

JEL: F33, F59, F65, G24

1. General considerations

At least 25 countries with trade surpluses already have sovereign investment funds, or are in the process of establishing such funds, the estimated total available amounts reaching some 3 trillion USD. It seems that in a few years, the sovereign investment funds will exceed in value to official reserves worldwide (Morris, 2010).

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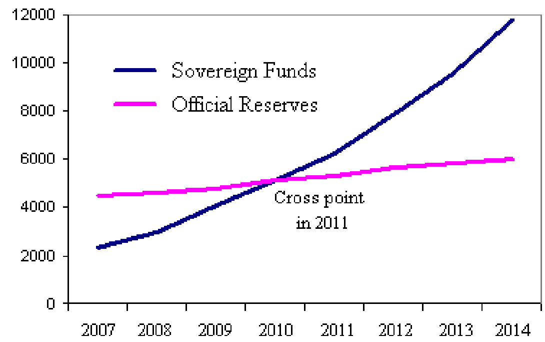
Fig.1 Comparative evolution of the sovereign funds and of the official reserves



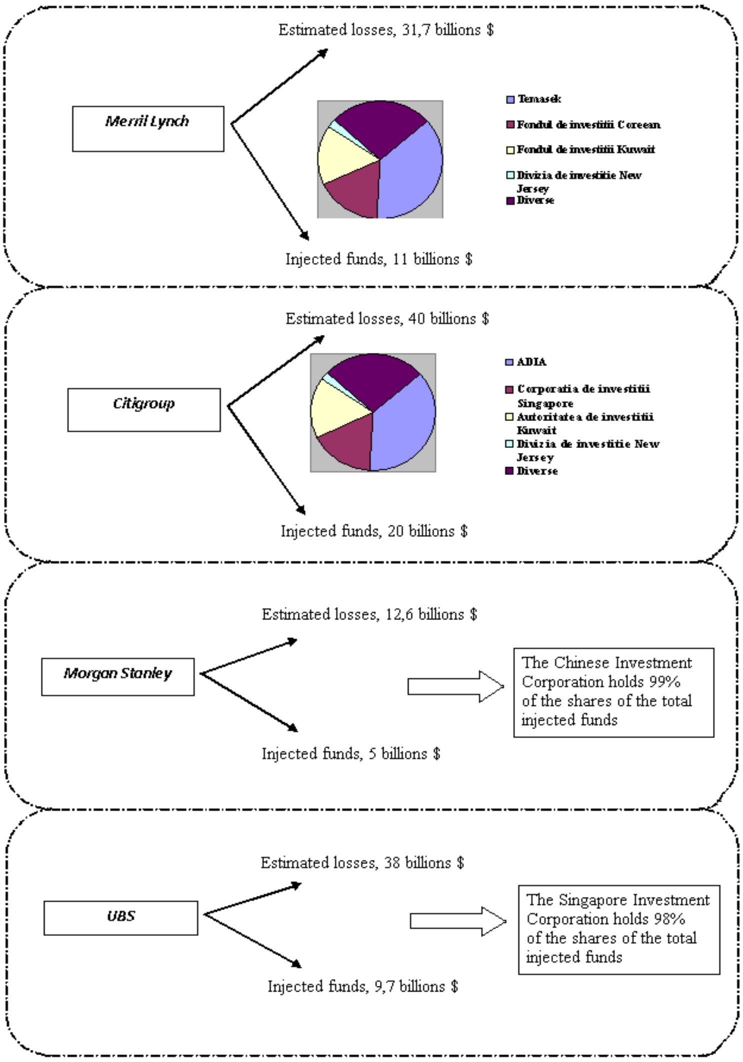
Source: Morgan Stanley investment bank report, May 2007

The sources of the sovereign investment funds consist in the reserves of the central banks (case of China), in the reserves for pensions (Norway), or the income from raw materials (Norway, Russia, Qatar); these sovereign investment funds are private funds under the control of the government, with the purpose to invest the surplus of reserves of the state. They are almost always located outside the official financial institutions, free from the investment limitations enforced on the official reserves.

2. The sovereign investment funds within the context of the global economic crisis

The sovereign investment funds used the opportunity of the global economic crisis to inject liquidity in some banks, companies and economies. Of these, one may notice the funds of the countries obtaining substantial incomes from oil, or of the large exporters, such China. As significant amounts of capital build up in these countries due to the favourable international trade flows, it was only natural for them to establish sovereign investment funds.

Fig. 2 Sovereign funds injected in the largest investment banks in 2008



Source: O'Brien, J., 2008, "Barriers to entry: Foreign direct investment and the regulation of sovereign wealth funds", 42 International Law, 1231

Previously to the global economic crisis, the activity of the sovereign investment funds was worrying the targeted countries, which feared of the political influence of the investment funds. The sovereign funds persist in a low transparency in terms of the amount of investment and losses, of their investment strategy, or their institutional mandate.

This attitude persisted throughout the economic crisis, but the sovereign investment funds have sizeable amounts of liquidities available for the targeted countries, and this is very desirable for these countries (Georgescu, 2012), more so as the sovereign investment funds usually invest on the long term and also display a tendency to overpay.

Relying on the national government, the sovereign funds have been outstandingly resilient to the effects of the crisis and to the significant losses incurred during it, assisting banks such as Citigroup, Morgan Stanley and Merrill Lynch, even if they sustained major losses, including for some of the corporatist acquisitions.

Owning larger assets than the private equity companies, financial funds larger than all the hedging funds worldwide and growth perspectives for their funds due to the increasing prices for commodities and energy and due to the larger trade imbalances between the West and East, the sovereign investment funds represent an increasing segment of the global financial sector.

The first sovereign investment fund was the Kuwait Investment Authority, established in 1953, to develop the local economy with the surplus from the oil trade. It belongs to the type of investment fund oriented towards the development of the national economy. Before the crisis it was worth 300 billion USD. Later, in 1956, the Revenue Equalization Reserve Fund was established, in which Kiribati deposited 400 million USD (450% of the GDP), obtained from the trade in guano (sedimentary bat excrements). The largest sovereign investment fund worldwide is the Abu Dhabi Investment Authority, established in 1976, with a value of 850 billion USD when the crisis started.

Using their trade surpluses, oil exporting countries such as Kazakhstan, Bolivia, Nigeria, Azerbaijan and Angola, are in different stages of establishing sovereign investment funds. In 2008, Saudi Arabia established the Public Investment Fund, with independent management, after it had previously administered 450 billion USD worth of surpluses from oil trade through a division of the central bank.

China has several hundred billion USD in several sovereign funds, the most known ones being SAFE Investment Corporation and China Investment Corporation, which invested in companies and assets considered critical by other states.

The western states too developed sovereign investment funds; however, they are fewer in numbers and have lower values because of the lower trade surpluses of those countries and to the more profitable internal investment opportunities. One of the outstanding sovereign funds is Norway's Government Pension Fund, Worthing 400 billion USD, third fund worldwide in terms of size. It was established in 1990 under the authority of the Parliament, for the profit of the state-owned oil company Statoil. The purpose of the fund is to ensure the future expenditure with the pensions; it is noted for its transparency and efficiency, while Norway is just on the 13th position in terms of crude oil reserves.

Of the funds characterised by transparency and which have a favourable political image, the Alaska Permanent Fund and the Alberta Savings Heritage Trust, stand out, their areas of operation having large crude oil extraction operations. In Asia, the Government Investment Corporation (established in 1981) and Temasek Holdings (established 1974) from Singapore, although they are not noticed for their transparency and governance, are highly efficient.

The sovereign investment funds are extremely different; they have different sizes and cannot be assigned to any particular typology, the classifications being vague and relying merely on the stated or perceived purpose of activity.

As types of sovereign funds, the most simple are the stabilization funds, whose purpose is to support the anti-cyclic economic policies. They store surpluses during the periods of growth, as state bonds, which are very liquid, and which can be sold instantly if necessary, during periods of crisis. Thus, in the oil producing countries, the sovereign funds gather assets during the periods when the energy prices are higher and supplement the revenues to the state when the prices for energy are lower. Such funds are easy to run and easy to liquidate, which is an advantage under conditions of maximum lack of transparency. Such examples are the sovereign fund of Kiribati Republic, the Russian sovereign fund Oil Stabilisation Fund, the sovereign Economic and Social Stabilization Fund from Chile, and the Investment fund for macroeconomic stability from Venezuela. The operating rules of the sovereign investment funds are very heterogeneous: some observe transparency and responsibility, while others have a lower responsibility and a higher opacity.

Fig. 3 ***Classification of the sovereign investment funds***

1. ***Stabilization funds***, whose role is to protect the budget and the economy against fluctuations in the price of commodities;
2. ***Savings for the next generations***, to stimulate the conversion of goods that cannot be renewed within a diversified portfolio of commodities;
3. ***Corporations for investments in reserves***, in which the goods are treated as belonging to the reserves and are established with the purpose to enhance their profitability, although they run higher risks;
4. ***Development funds***, established with the purpose to finance the socio-economic and infrastructure projects;
5. ***Contingent pension reserves***, established in order to finance the social security and to cover the health care expenditure.

Another type of sovereign funds is represented by the saving funds which invest in the national wealth, with the purpose to distribute it subsequently (such as Norway).

The purpose of most numerous sovereign funds is strategic development. They buy companies from key-industries, open branches in the country of the sovereign fund and/or make know-how and technology transfer, encouraging sometimes the development of the local industry by transfer of production capacity. China does such operations. Thus, the disastrous investment in the Blackstone investment fund (2 billion USD losses shortly after 3 billion USD investments) aimed not only to make profit, but also to make know-how transfer in assets management, risk management and in other categories of financial expertise. Singapore is another state that uses sovereign funds for strategic development purposes. It invested aggressively in telecommunications and banking through the Temasek sovereign fund. Saudi Arabia and Qatar invested in agricultural land and in food industry, with the purpose to ensure their food security. China directed its investments towards the supply of raw materials (in Africa and South America) or in controversial commodities (arms, military technology, nuclear fuel). The states have several sovereign funds, diversified according to their purpose. Thus, Abu Dhabi Investment Council invests in high-tech industry which it brings to the emirate, the Government Investment Corporation from Singapore invests in financial assets, Temasek sovereign fund from Singapore invests in strategic industries, while the Kuwait Investment Authority is a passive holder of portfolios.

Another type of sovereign funds develop sovereign wealth enterprises which act towards a particular purpose in a particular field, in order to avoid publicity and the limitations imposed to the sovereign investment funds by their initial mandate. Such example is the Qatar Investment Authority which owns Hassad Food, which makes strategic acquisitions in the food industry.

3. The continuous ascension of the sovereign investment funds

The proportion of the sovereign investment funds within the global finances is likely to increase. By their value, they are significant for the system as a whole because they are fuelled by the high commodity prices and by the long-term disequilibrium of the trade balances, by their goal of national development and of getting maximal political, social and economic benefits for the whole country. Thus, despite the major losses due to the crisis, the holder states continued their support, the cumulated economic influence of the profits leading to the development of political power within the context of the global need for investments.

The rise of the sovereign investment funds highlights the institutional and absorption deficit of the domestic economies of those countries. Thus, the Abu Dhabi Investment Authority stated that no accomplished investment will be used as instrument of foreign policy. In order to alleviate the adverse publicity, some sovereign funds associate in investments with other sovereign funds that have a better reputation (for instance, CIC invested in natural gas in America, next to investment funds from South Korea and Singapore).

Concerns were noticed for the reform of the system to make it more transparent. Thus, the Santiago Principles adopted in 2008, under IMF aegis, by 26 sovereign investment funds, include 24 recommendations among which observation of the transparency rules of the host country where the investment funds do business. However, the observance of these principles is voluntary and there are no penalties in case of breach of the principles. Under these circumstances, there are sovereign funds with assets worth of hundred billion USD which publish no kind of information, not even annual reports. These faults are presently overlooked because these investment funds are necessary to the global community.

Within the context of the crisis, some sovereign investment funds acted with caution. For instance, Temasek, with an excellent reputation, invested in two companies of mobile phones in Indonesia, during the Asian crisis, using a local partner, buying minor packages, staying out of management and avoiding flame up the local nationalist feelings.

4. Future evolutions in the perspective of 2030

Due to the heterogeneous character of the sovereign investment funds, their future evolution displays different priorities, methods and levels of transparency. Owning assets worth of trillion USD, the sovereign investment funds accumulate interests in purely private companies by transborder investments; this will probably cause protectionist bursts of the states within the context in which, for the first time since the 15th century, the western states are likely to yield their power challenged by the ascension of the emerging powers.

Having as main finding the decline of the West (Anghel, 2013), the January 2013 strategic report of the National Intelligence Council (NIC), the American bureau of geopolitical and economic forecasting, „Global trends 2030 – alternative worlds", shows that although the USA will remain one of the main world powers, they will give up the economic hegemony in favour of China. Within the new, multipolar world, in which the regional poles will be China, India, Brazil, Russia and South Africa, China will dispute its international supremacy with the USA and its historical allies – United Kingdom, France, Germany and Japan. In 2030, the proportion of the western states within the world economy will shrink from the currently 56% to just 25%. Therefore, the West will lose its economic dominance, and one of the main consequences will be the lack of financial means for the world military supremacy, structural change that will be worsened by the deep present economic crisis. During the Asian era, a strong China will lead the triumph of Asia, stronger than the USA and Europe together in terms of the population and GDP, of the military expenditure and technological investments. The report shows the prominent place of the USA, which has energy independence due to the schist gas and oil. In 2020, the USA might become the number one world producer of crude oil, outdoing the current world leader, Saudi Arabia, and this might shatter the power relations.

The mentioned CIA report considers that the crisis will last at least one more decade in Europe, until 2023, showing uncertainty about EU cohesion.

The report confirms the emergence of China as the second world power and its soon ascension to the top position. The report also states the simultaneous rise of the BRIC countries (Brazil, Russia, India and South Africa) on the second position and their direct competition with the former dominant JAFRU countries (Japan, Germany, France and the United Kingdom).

It also shows the emergence of several intermediary powers on the third position. These are countries that display demographic and economic growth and which will become regional hegemonic poles that will likely cluster in a group with world influence – CINETV (Columbia, Indonesia, Nigeria, Ethiopia, Turkey and Vietnam).

It seems that by 2030, when the most populated countries will be India and China, with Russia on the 10th position, within the new international system, the largest communities will no longer be states, but reunited communities interconnected by the internet and social networks, having a decisive influence in the world policy.

5. Conclusions

The foreign trade balances of the emergent countries (huge surpluses) turned the sovereign investment funds into first grade investors; the governments that have at hand huge amounts of money became influential players on the financial markets through these sovereign funds, and the political component is often there too. The strong ascension of China and of other emerging economies has a decisive contribution to the revival of the world economy, according to OECD.

The economic crisis which started in 2008 prompted the sovereign investment funds to take active position on the financial markets, contributing by their massive interventions in support of the European and American banks, to the relief of the world economy, according to the data centralised by the Sovereign Wealth Fund Institute, independent organisation which monitors the activity of the sovereign investment funds.

There are both economic and political consequences of the consolidation of the sovereign investment funds; they influence the substantial change of the world power balance within the emerging new political and military multipolar world, with a significant increase of the interdependence between the national economies. Drive of the global economy growth, China will outgo the USA by 2030, while by 2050, the GDP of China will amount to 70,000 billion USD, twice the American GDP of that time.

Standing out as the new extremely competitive pole of the world economy, with an irresistible growth of the economic, financial and military power (by 2049 it will be the main military power in the Asia-Pacific region) (Beech, 2013), with an active diplomacy and displaying the will to grasp all available resources, emerging superpower, China fascinates, worries and disturbs, while exerting an increasing influence on the phenomenon of globalization towards the great convergence, as fundamental change of the world whose balance of power shifts towards the East.

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