

Administrative Aspects of Ensuring Financial Stability

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Abstract

As the current crisis shows, financial stability plays an essential role for the financial system and for the economy as a whole. Given the ever increasing number of financial institutions which are currently active in two or more countries, or on two or more continents, the worldwide financial stability became even more important.

In order to protect the financial system and to ensure the financial stability, we need to identify the main sources of risk and vulnerability, and all of the involved parties (such as the financial institutions and the monitoring authorities) must be informed on the risks.

Keywords: *financial stability, risks, instability, macroeconomic balance, market discipline*

JEL Classification: *F36*

Introduction

Financial stability refers to the determination of the defining elements of most financial economic activities (credit administration, investments administration, placements administration) within macroeconomic evolutive context; it signifies maintaining these elements within the interval of limits whose dimension does not exceed the acceptable level of risk.

Generally speaking, financial stability is influenced in a decisive manner by the main characteristics of the macroeconomic trend – the potential risk of instability is determined by a group of macroeconomic factors which have direct and immediate impact on the state of stability.

An initial claim would be that, in terms of the potential risk of financial instability, the risk of volatility and the risk of instability of the financial risks involved in financial economic activities is high, the main factors of influence being in a direct relation of proportionality with the economic risks specific to the environment and/or region where the activity takes place.

The current macroeconomic context is characterized by a cumulus of economic effects generated by the insufficient macroeconomic administrative capacity in relation with the system of the real economy which, consequently, induce an increased potential of volatility and instability of the financial resources involved in economic activities, a high level of risk of financial instability.

The progress of all economic programs, specific to the actors of the economic market, or to the macroeconomic administrative system, is strictly conditioned by the involvement of the financial resources. The objectives of macroeconomic stability and sustainability are conditioned by the maintenance of the state of financial stability within an interval whose limits are at an acceptable risk level.

Consequently, the importance of maintaining the financial stability is basic for setting the progress of the economic programs so as to accomplish all assumed objectives.

Directions of Action at the Administrative Level

Recapitulating, the main aspects of the problem of financial stability are as follows:

- a phenomenon of destabilization can occur in any economic area of the region, including at the level of the union;
- the production of the risk of transmission of the effects through the transmission channels specific to the process of European integration, amplifies the risk of destabilization, both due to the effects thus transmitted, and as importance of the phenomenon;
- the progress of the process of European integration relies on the macroeconomic balance of the entire region, considered both at its national, and at its union dimension;
- generally speaking, the aspect of macroeconomic risk and, particularly, the aspect of the risk of financial or monetary destabilization, considered within the context of the process of European integration, compel the correlation of the macroeconomic administrative capacity with the real potential of evolution of the phenomena and processes to be administrated;
- the risks of financial and monetary destabilization are acting in an opposite direction to the process of European integration;
- the relation between *national* and *union*, at the regional level of the process of European integration is a relation of construction of a macroeconomic system, based on balance and sustainability.

Considering all these aspects, the assurance of financial and monetary stability during the process of European integration becomes imperative. This activity has the following coordinates:

- it is indispensable to monitoring the macroeconomic objectives both while the process of European integration is in progress, and after it is finalised;
- it includes separate aspects and approaches according to the two types of stability;
- the institutional architecture and the functionality of the administrative activities associated to securing the financial and monetary stability are specific to each stage of the process of European integration;
- at the end of the process of European integration, the institutional architecture and the functionality of the administrative activities associated to securing the financial and monetary stability become unique at the regional level.

In terms of dimensions of the administrative activity assuring the financial and monetary stability, we have the following main elements:

- the administrative activities assuring the financial and monetary stability comprehend:
 - market construction activities:
 - regulation;
 - supervising;
 - managing the progress of specific flows:
 - monitoring;
 - regularization;
 - activities of communication within the macroeconomic administrative system;

- the dimension of involvement of the administrative activities assuring the financial and monetary stability in the real economy, has the following characteristics:
 - risk management;
 - stimulate market functionality;
 - ensure the freedom of movement for the market actors within the context of the macroeconomic objectives;
- a general characteristic of the administrative activity to ensure the financial and monetary stability is the correlation of the administrative capacity with the action potential of the real economy;
- the characterization of the administrative activity to ensure the financial and monetary stability specific to the association with the process of European integration, includes the following elements:
 - it is specific to the requirements of functionality necessary for the construction of the community's economic system;
 - it is specific to the functionality of the encompassed economic area;
 - it is designed from the beginning as component within a single administrative system.

With a view to approaching the main underlying elements of the design of an administrative system assuring the states of financial and monetary stability, one should note that conceptually, in terms of functionality, this administrative system will act in two directions:

- managing the risks of destabilization of the state of stability
- managing the situations of destabilization of the state of stability.

Regarding the case of financial stability, given the conceptual elements included in the definition from the beginning of the analysis, and the fundamental aspect mentioned earlier, the activity of ensuring the financial stability will have to act in the following directions:

- managing the risks of deregulation of the financial stability;
- managing the situations of deregulation of the financial stability.

Among the factors bearing a direct influence on the deregulation of the state of financial stability we have:

- conjunctural factors – specific to the perception of the investors regarding comparative aspects between the different macroeconomic levels of the region;
- macroeconomic factors – specific to the country risk from the perspective of the macroeconomic administrative capacity to ensure a proper trend for the assumed objectives;
- risk factors – specific to the occurrence of risky phenomena which bear effects on the development of the macroeconomic programs.

On the grounds of the aspects we may produce a first set of conclusions:

- Regarding the characteristics of the state of financial stability:
 - it is perceived in relation with the investment interests within the market;
 - it is highly sensitive to the options underlying the investment activities;
 - it is the link between the demand and offer on the financial market;
 - it connects the aspects of microeconomic performance with the investment interests;
 - it connects the aspects of macroeconomic balance with the investment interests;
 - it can be seen, at the same time, as result of the microeconomic performance / macroeconomic balance and as indicator of the risk level associated to the two economic levels;
- Regarding the dimension of the administrative activity to manage the risks and the situations of disturbance of the financial stability, which must related to:
 - assuring the macroeconomic balance;
 - aspects of market discipline, represented by the activities of regulation and monitoring;

- institutional factors with similar activity within the region.

Considering these aspects, the main elements of the administrative activity to manage the risks and the situations of disturbance of the financial stability are:

- character of complexity, with action both within the sphere of the macroeconomic policies, and within the sphere of the market;
- regional coverage, with activity focused on the internal macroeconomic problems and connected to the aspects resulting from the participation in the program of regional economic integration.

On the grounds of these conclusions, here are several design elements of the administrative activity to manage the risks and the situations of disturbance of the financial stability:

- it is a multi-institutional activity;
- it takes place at the national level within the context of European collaboration;
- it is configured with the objective of the institutional and theoretic-methodological unification at the regional level;
- it undertakes actions of prevention and correction of the adverse effects generated by the development of the real economy activities;
- the limit of involvement within the real economy is set by the generation of constraints by the microeconomic activities.

In addition to these characteristics of the administrative activity to manage the risks and the situations of disturbance of the financial stability, given the coexistence, at the European level, of the process of European integration and of the phenomenon of economic polarization of the region, generated by the process of economic globalization, and considering that the phenomenon of economic polarization of the region yields economic effects opposed to the process of economic globalization, we propose, as design characteristic of the administrative activity to manage the risks and the situations of disturbance of the financial stability – particularly for part of the risk management– interventions which should stimulate the real economic activities in opposition to the economic polarization of the region. All the mentioned characteristics of the design of the administrative activity to manage the risks and the situations of disturbance of the financial stability approximate the state of financial stability show that it is *admissible* that the volatility of the financial assets is reduced to an allowed maximal level, so that the market value of a financial asset be included within the interval:

$$V - \varepsilon < V < V + \varepsilon \quad (1)$$

where:

V = value of the financial asset;

ε = variation of the value of the financial asset.

This is so, because the option to maintain strictly the level of financial stability, the volatility of the financial assets' value:

- would mean administrative pressure to limit the actions to the level of the real economy within the regional context of the *single market*;
- practically it would be impossible to achieve the condition $\varepsilon = 0$, because unforeseen disturbing factors of the financial stability may occur any time.

In conclusion, the administrative activity to manage the risks and the situations of disturbance of the financial stability will have its place within the institutional and technical-methodological framework of the macroeconomic activities specific to various institutions of the macroeconomic administrative system, displaying a trend towards regional unification, as the various stages of the process of economic integration unfold.

The assurance of monetary stability is specific and associated to the activity of monetary policy administration.

Risk Elements within the Context of the Financial Instability Evolution

The potential evolution of the phenomenon of financial instability, considering the pattern of the economic market at the regional level, can be perceived as volatility of the financial resources and can be the result both of the phenomenon of economic globalization – seen phenomenologically through the prism of the composing elements of regional economic polarization, and of the processes of economic integration which, during the first stage of constitution of the economic union, are associated phenomenologically and motivationally, to the phenomena of economic polarization within the process of globalization, overlapping them and having a cumulated effect opposite to the regional economic integration.

Using the definition proposed for the concept of financial stability, the evolution of the phenomena of regional economic polarization can induce financial instability due to the higher volatility of the financial assets and amplified by the activities from the financial market.

The higher level of regional financial instability within a region undergoing phenomena of economic polarization may generate a trend of polarization of the regional financial assets, corresponding to the economic polarization.

In consequence, it will amplify the gap between the economic markets of the different areas of the region, which is a risk in several directions:

- the trend towards wider gaps between the economic development of the particular areas composing the region; this will increase the risk of shocks within the regional economic relations;
- a higher risk of evolution of phenomena which oppose the objectives of economic integration.

Taking the pattern of the European Union with its current stage of the process of European integration, we need to take into consideration that two evolutive phenomenological forms overlap within this region:

- the process of European integration;
- the phenomenon of economic polarization which is associated to the phenomenon of globalization.

The relation of the two phenomenological forms with the financial stability is that, during their evolution, the phenomenon of regional economic polarization develops. As it evolves, this phenomenon is expected to enlarge the areas of economic polarity, by approaching gradually the different segments of the regional market, the expected outcome being the reduction of gaps between the different regional markets.

Having in view this economic pattern and the current stage of evolution of the process of European integration, corresponding to the early stage of the phenomenon of economic polarization, it is important to remember, for the purpose of this analysis, that the phenomenon of economic polarization is associated to the phenomenon of financial assets volatility in the areas affected by economic polarization mainly due to the associated phenomenon of financial polarization; in association with the effects of the movement of funds on the financial markets it may imbalance the financial stability. As evolution, this form of imbalance is brief, most probably, until a new balance is reached, a new position of the state of financial stability, at lower levels than the previous state of stability; temporally, it precedes the start of the phenomenon of regional financial polarization.

Consequently, the evolution of the phenomena of economic and financial polarization produces a chain of states of financial imbalances which yield substantial gaps in the state of financial balance of the areas composing the region and the development of the different local markets composing the regional market. These results are opposed to the interests of the project of Economic integration, hindering its evolution.

The further evolution, of this economic pattern may lead, provided there are no risky regional phenomena, to lower economic gaps between the areas composing the region; this can be done by expansion of the economically and financially polarized areas, while resetting the levels of financial stability in the different areas of the region, with the purpose to accomplish the objectives of the process of European integration. The problem of financial stability may also be approached at the regional level too.

The potential economic pattern of the onset and evolution of the state of financial instability is introduced gradually, starting with a flux of outflows of sources of economic growth – possibly relying on the principle of globalization and establishment of the areas of economic polarity – which generates some kind of macroeconomic fragility. On this basis, the aspects of financial instability may gain momentum, mainly as:

- imbalanced relation between the demand and offer from the financial markets, due mainly to the:
 - lower number of actors on the financial market;
 - lower correspondence between the offer of the financial market and the GDP, due to the trend of lower GDP;
- higher macroeconomic fragility due to the lower potential of economic growth because of the same imbalances of the demand/offer relation and their effects; this generates subsequently a higher risk of inadequate reception of the shocks and adverse macroeconomic phenomena on the background of macroeconomic imbalances which, in turn, produce further effects.

Reverting to the administrative aspects of approaching the issue of financial stability, we propose to deal with them in relation with the corresponding risk problems, as follows:

- problem of the financial stability;
- problem of the risk of imbalance of the financial stability.

Solving them requires going through the following stages:

- identification of the concepts and of their correspondence with the economic reality;
- identification of the factors determining the economic stability;
- identification of the risks of imbalance of the financial stability;
- identification of the directions of action necessary to:
 - monitor the provision of financial stability;
 - manage the risks affecting the provision of financial stability.

Based on these considerations, an administrative pattern for financial stability should rely on the following directions:

- working areas of the activity:
 - Monitoring the action of the factors which influence the financial stability;
 - Risk management, for the action of each of the factors which influence the financial stability;
- theoretical-methodological directions:
 - Identification of the main factors of influence affecting the financial stability;
 - Identification of the main ways which lead to the onset of the state of financial instability;
 - Identification of the way in which each factor of influence works;
 - Identification of the possible related elements of impact, felt by other economic sectors;
- design the infrastructure for the future risk management strategy;
- design the risk management strategy.

Conclusions

The importance of ensuring the state of national macroeconomic financial stability, particularly within the context of the running process of European economic integration, results from the following aspects:

- financial stability is one of the defining qualitative aspects for the balance of a macroeconomic system;
- financial stability is an indicator of the option for investments and placements for the particular macroeconomic area;
- exceeding the limit of admissibility of volatility of the financial assets is an indicator of the financial risk which, within the context of configuration of the European economic relations, may produce effects transmitted through the channels specific to the progress of the process of economic integration;
- the relation between the provision of financial and monetary stability results both from the objective of preserving the macroeconomic balance, and from the functional connection between the macroeconomic administrative system and the real economy;
- the disturbance of the financial stability may also result from the disturbance of the monetary stability;
- the two types of stability result from the state of macroeconomic balance;
- regarding the factors of influence of the two types of stability, both are multi-variable functions, some variables being common for the two functions;
- the administrative action towards the provision of the two types of stability is multi-disciplinary, multi-institutional and submitted to the process of regional economic integration;
- in terms of quantification, the level of stability must be seen as belonging to an interval delimited by boundaries that are acceptable in terms of risk;
- institutionally, the activities ensuring the states of financial and monetary stability are included within the macroeconomic administrative system and they are connected to the process of European institutional and technical-methodological construction.

The use of financial instruments to monitor the financial stability, macroprudential analysis included, should focus on the overall financial system; this type of monitoring is of maximal importance for the identification of the potential sources of instability, for the activities limiting the risks and avoiding the high costs incurred with solving the potential situations of major risk. Therefore, it is necessary that these surveying methods – the combination of monitoring and regulation activities – must be relevant for the existing conjuncture in agreement with the set objectives, it must be reliable, easy to apply and standardize. The accounting standardization is also important for the easy application of these surveying activities; periodical stress tests must be applied in order to determine the potential macroeconomic adverse impact of the shocks under different economic circumstances and with different responses of monetary policy.

Market infrastructure plays a central role, because financial stability is very much influenced by the environment in which the financial intermediaries operate. As there are cultural differences, there also are structural differences between the individual countries. The nations have a diversity of political and economic systems, their legal and taxation frameworks play a central role in the development of their financial systems. The national influences may interact and definitely act upon the practices and procedures implemented by the regional financial markets.

Some risks of financial instability may appear now and then; the central banks and the surveillance authorities should therefore make a priority from the formulation of a properly structured strategy to address the potential financial imbalances. Such strategies should cover the following areas: coherent political framework for the macroeconomic administrative system, which to ensure the implementation of a framework of logical macroeconomic policies, which is essential for the maintenance of the financial and monetary stability. This framework should be

consistent in accomplishing the macroeconomic objectives and should avoid the build-up of imbalances than may result in financial instability. Another area is the supply of market directions to the market actors about the functionality of the policy that facilitates the decision-making process at the microeconomic level. Moreover, the flexibility to react at shocks that often disturb the economic process helps dampening the risks of financial crises.

These strategies should also encourage the development of efficient and prudent risk management systems; they should make sure that these systems are correctly monitored and managed as to the regulation requirements for risk management and for a higher risk transparency.

Market discipline, as another essential element that is indispensable for the provision of financial stability, must be promoted by prudential regulation and by surveying, which to allow and impose at the same time, the performance of the specific market activities within a framework favourable to financial stability.

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