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Changes in economy or changes in economics?

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**THE ROMANIAN ACADEMY
THE NATIONAL INSTITUTE OF
ECONOMIC RESEARCH**

WORKING PAPERS

Changes in Economy or Changes in Economics?

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CHANGES IN ECONOMY OR CHANGES IN ECONOMICS?

LUCIAN-LIVIU ALBU*

There are evidences that the actual global crisis affected the convergence process in EU. Generally, just new adhered countries were more affected by the actual crisis. Today all forecasts are suffering by uncertainty. Last time, economists, with their methods and models, are invoked for actual crisis, but real causes could be found in policymaker's actions and in public opinion's influence, as a rule focussed only on short or very short-term. However, the methods and predictive models that economists are using seem to be not adequate for the new situation, especially due to the large extension of the actual crisis, at its turn caused by the globalization phenomenon. For the post-crisis period, we are presenting some likely challenges both in the real economy and in economics. There are different opinions regarding how deep and how long the convergence process will be affected. Synthetically, the pessimistic authors are viewing the future economic dynamics as one of so-called L type or U type or W type. Coming from lessons supplied by standard economic growth theories (Ramsey model, Solow-Swan model, Mankiw, Romer, and Weil model, etc.) and by empirical evidences, we are considering the convergence in the level of income per capita as a result of structural changes in economy.

Keywords: *convergence, structural changes, spatial distribution, inflation - interest rate - growth rate correlation.*

JEL Classification: *A11, B41, C13, C31, E27, O11, O47, O52*

1. Economists should not be accused

The current global crisis has indeed multiple causes. If the economists are honest, currently some of such causes are ignored in their analyses and studies. However, this is not a reason to accept a general panic in public opinion (often manipulated) or the “natural” tendency to the populism of politicians. In case of a rigorous analysis one can see that just these two forces (often chaotic and therefore unpredictable) attracted the economic system in hazardous situations. Under the impact of their actions would be added an infernal race to have exaggerated profits in case of some

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capitalists, undeserved incomes in case of some employees (generally stimulated by trade unions), rapid and exaggerated consumption in case of some households, increased material advantages in case of some assisted persons, etc. When such tendencies are generalised, the resulting imagine could be a bleak: economic agents, including the “representative agent” at the macroeconomic level, presumed to be rational, by economic theory, begin to demonstrate some strange behaviour ranging from atypical to the irrational. In this extreme case, theory and economic models have increased chances to fail. Worse, the economy itself, as a whole, it can collapse.

Time has (or should have) a crucial role in the economy. Public opinion (fostered and manipulated) and politicians usually act on the very shorter term, on the moment even if it is possible. In line with these two forces, a number of economic agents tend to adjust their behaviour to the same short-term. Apparently, it can be regarded as a better adaptation to the rapid changes and trends in the economy and society. The question is: trends toward what? For reckless consumption, followed by depleting natural resources and environmental pollution? Towards a culture of consumption for consumption's sake? (see aggressiveness and ubiquity of the commercials urging for it); For an economy where productivity becomes irrelevant in relation to the stock market speculation (or real estate) and the consumer credit tends to replace income from work? For a society where the volume of consumption determines the social status of a person or a family?

Economic theory is based on two basic principles: 1) the laws of economics are true only on long-term, 2) the large number of rational economic agents. It seems that in the pre-crisis period those two principles have been severely violated. And economists have no fault. It should nevertheless be acknowledged that the economists have largely discovered before the current crisis: often the methods and predictive models they are using are inadequate for the new situation, especially due to its degree of expansion caused by globalization.

2. How will be the post-crisis economy

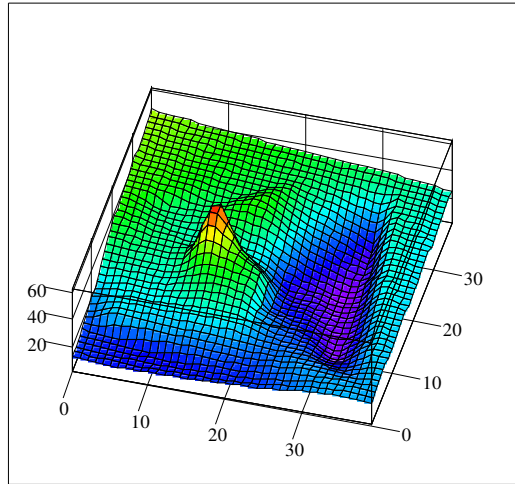
It is almost certain that in order to become sustainable, the economy, at national and global level, will suffer profound changes. It is assumed that the

economists, blamed in early stages of the crisis, will be called to contribute to the “restructuring” process, both at the macroeconomic level, by using more refined analysis of the correlations between macroeconomic variables (affected by the recession) and at company level, by providing viable solutions to operate in a economic environment still uncertain for a period.

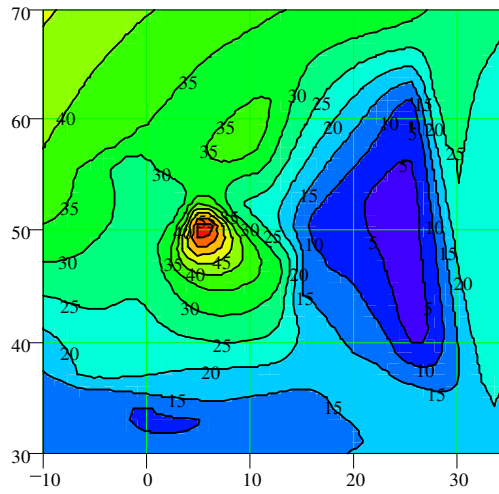
To exit from the crisis, there was a tendency for state intervention in the economy in many countries. Although to a degree this may be a saving solution should then, according to economic theory, the main role to keep only the social aspect and security. Maintaining strict state regulations required only in the area and ensure the general framework, it would avoid its "natural" tendency to vitiate markets, competitive system and, ultimately, even the system of modern democracy. Although there is still intense debate on the "optimal state", the studies research on evaluation of its size will prove useful in post-crisis period.

Worldwide, the main change will be evolving in increasing the influence of countries until recently considered emerging, like China, India, Russia, Brazil, etc. Mutations will probably be between large economic blocs, the progress of the Asian region is already felt in global trade.

At the European level, after the recovering process in countries seriously affected by the crisis, it will certainly resume the convergence program promoted in the European Union. Perhaps, given the serious effects of the crisis within the European Union, moreover it will try to correlate other policies and strategies, as for example the tax policies. Regional disparities in pre-crisis period in terms of development level, expressed by GDP per capita are likely to persist as a result of the crisis, still a long time. Figure 1 presents a stylized map of the EU, where blue areas signify low levels of GDP per capita, while the red areas mean high levels. Figure 2 presents a stylized map of the EU in terms of inflation distribution, in which blue areas signify low levels of inflation and red areas signify high levels.

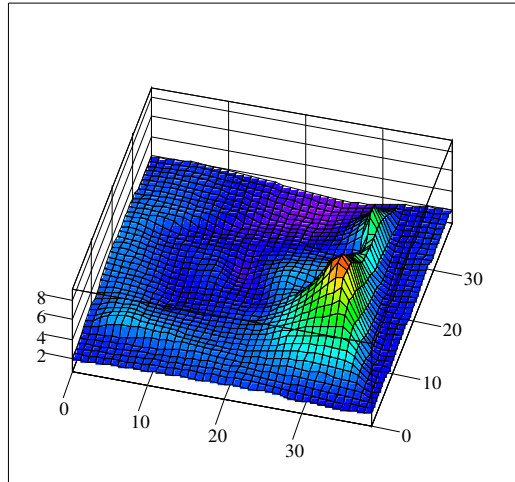


LO, LA, y

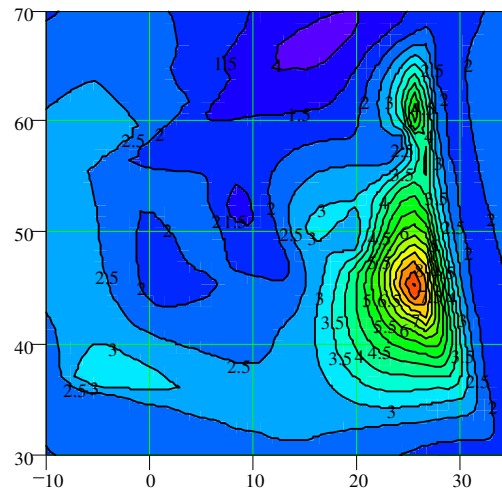


LO, LA, y

Figure 1. Spatial distribution of GDP per capita in EU before crisis



LO, LA, π %

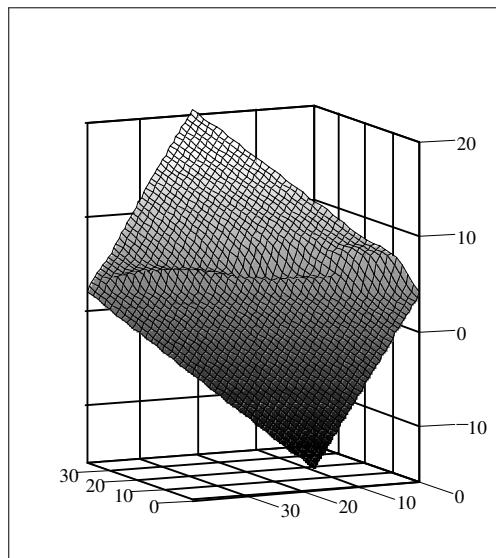


LO, LA, π %

Figure 2. Spatial distribution of inflation in EU before crisis

Romanian economy, one of the most affected by the current crisis will probably engage in a comprehensive process of restructuring, postponed due to a long period of transition. One of the basic correlations which should be taken into account, as in classical economic theory, is between consumption and investment. The role of budgetary investment will be decisively in recovering process, given the shortage of private capital (both domestic and foreign) as a result of the crisis. Also, public sector, over-extended in the past, will likely be re-scaled according to the EU standards.

For Romania, essential for the future should be to resume the process of convergence towards the European average, meaning to return to an annual growth rate of potential GDP of around 5%, as was the case in the pre-crisis, but of course in conditions of much lower inflation and interest rates. In Figure 3 are shown the 3D and geodesic (contour plot) representations of the correlation among inflation (p) - interest rate (i) - growth rate (r), where the diagonal line marked by the contour line 5 can be interpreted as the value of potential growth rate.



p,i,r

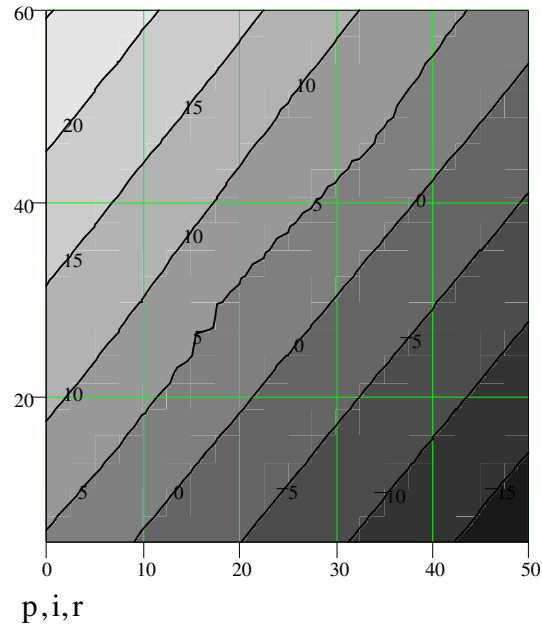


Figure 3. Inflation - interest rate - GDP growth rate correlation before crisis

3. How will change economics in post-crisis period

Economics will probably suffer significant changes in post-crisis period. We present below some predictable trends, such as:

- development of macro models using time series with high frequency (quarterly or even monthly macro models);
- creation of advanced simulation models for public debt and deficits;
- use non-linear modeling and multiple equilibriums for early detection of entry of fundamental macroeconomic variables in areas of high instability (when slight variations of some basic parameters or state parameters could attract economic system in zones characterized by irregular cycles or multi-cycles, by high fluctuation and even chaotic dynamics);
- development of more refined models for multiannual budgetary planning, etc.

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