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THE INEFFECTIVENESS OF STATE AS CONTROLLER AND OWNER

The global market is largely a game without rules and without an arbitrator able to dispense necessary medicine. Undoubtedly, the crisis has caused the emergence of new challenges, which require the active role of the state in various areas. States play the role of owners of companies and market regulators. Unfortunately governments were not performing these functions adequately. Those therefore, who themselves committed many mistakes, must improve not just the mis-functioning market, but also a defectively functioning state; or, to put it otherwise, they must improve themselves.

1. The state as owner of companies

Ever faster changes, rapid capital flows, and financial crises make it necessary to bring the question of what the state can and should do in such a changing world. For many years, a debate has gone on in the world concerning the need for radical changes in our civilization. Repeating crises intensify these discussions[1]. The neo-liberal system, quickly spreading as a consequence of liberalization and deregulation, is viewed by many as a system that is not able to meet the challenges of the future. It is a system that exceeds the limits of growth, and fosters speculative enrichment and growing social disparities. Opinions about the end of capitalism (J. Rifkin) are being expressed today, just as previously we heard about the "end of history" (F. Fukuyama). Postulates to democratise globalisation or to globalise democracy (B. Barbier) appear, as do postulates advocating anti-bourgeois revolutions (N. Klein) or the construction of "controlled capitalism" (J.Żakowski). The last crisis has caused a widespread call for the establishment of a super-supervisor of the financial market. The growing importance of financial markets, the emergence of new institutions and financial instruments, and the development of speculative capital are often cited as factors underlying the current difficulties of the global economy. These are not just related to the current crisis, but also result from the increasing social and environmental problems (exceeding the limits to growth has led to energy shortages and climate problems).

Reduction of the co-ordinatory capacity of markets, that expresses itself in recurrent crises, requires consideration of whether these market failures can be addressed by specific actions of the state. This question is even more reasonable when we take into account the fact that the state itself is also largely contributed to the crisis[2].

[1] King 1992, Gore 1996, Tofler 1996, Stiglitz 2007

[2] Some even speak about an excessive impact of the state: „The problem is not capitalism or excess of capitalism, but rather a shortage of capitalism mixed with interventionism. Governments disturbed the natural equilibrium of the market economy with subsidies, taxes, and various regulations. People who try to manipulate capitalism are the main problem. Politicians, who instead of solving problems, decide to increase debt and introduce even more regulations. His (Obama's) reaction to growing debt and credit

The state does not perform a good job as an owner, market regulator, and operator of monetary, fiscal and exchange rate policy. History provides many examples of irregularities on the state. Defective framework for the financial sector, too, was designed by public authorities. Excessive lending scale, detached from the size of the economy, was a consequence of a specific monetary policy.

In many countries the state is the owner (co-owner) of many companies. Previously described processes of nationalization make the increase of this role of the state possible. It should be emphasized, however, that a number of negative consequences occurs, when the state acts as owner. I do not want to say that the State may not be the owner of businesses, or that state ownership must always be irrational. Such a finding would be inherently wrong. My point here is merely to indicate the existing serious threat.

In the case of state-owned enterprises all previously discussed irregularities in the functioning of the supervisory boards manifest themselves. Thousands of jobs in state enterprises are distributed among party activists or their families. Companies associated with politicians contracts from companies controlled by the state. Such irregularities have occurred in many countries.

The situation, for example, in Polish state owned companies was rather well presented in recently completed report by the Supreme Chamber of Control (NIK, a state control institution responsible to the parliament). In Nafta Polska (Polish Petroleum) from 2004 to 2008 seven people had the job of CEO, and on average none of them worked more than a year. Similarly, in the plastic company Gamrat, at the same time made five changes in the board took place. In the Nitrogen Plant in Pulawy 12 executive searches were initiated. Problems with board members' exchange occurred in many other companies. In such circumstances there is no possibility of effective governance, or of implementing any strategy. New CEO's came with new ideas and employed new "friends". After working only a few months, many were paid out huge "farewell" checks. Another example of mismanagement and lack of supervision may be the computerization of social security

Another problem is the improper selection of members of supervisory boards. In 2008 469 employees of the Ministry of the Treasury, or 67% of all employees, sat in one or two boards. Often they were appointed to boards of companies that were controlled by the very same departments in which they worked, which bluntly put means, that they controlled themselves. Supervisory board appointments were made in order to grant them an additional salary, without any respect for the actual needs of companies or their qualifications.

Various irregularities were detected by NIK in every third company controlled, while losses from improper supervision have been valued at five hundred million zlotys. This loss is in my opinion very underestimated. Only what could be easily counted was taken into account. The effects of inadequate supervision or lack thereof can be much larger and appear over many future years.

Another example is the ineffectiveness of State Social Security system, and especially the computerization of the institution, which already cost more than sending probes to Mars. The contract cannot be dissolved, and Social Security is not even the owner of the software source code, which it bought. This institution works like it had neither management nor supervisory boards at all. But the State does not care very much and, moreover, proposes to limit the transfer of funds for future retirees to private pension companies, and direct them to the State Social Security[3]. The institution is considered by many to be bankrupt.

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dependency was even more debt and credit... this is just make-up covering greater problems in the future." Interview with Peter Schiff, Super Express, October 29, 2009.

[3] It is interesting to note, that such proposals are being made by the Minister of Labor designated by the Peasant Party PSL – a Party that over the last decades has valiantly defended KRUS (Agriculturers' Social Security), a very ineffective and extremely costly (for the urban taxpayers) pension system for the agricultural sector which pays almost no taxes or social security premiums at all.

These same problems occurred for a long time. So far it has not been possible to create mechanisms that would have eliminated them. The only solution to these problems was, as before, privatisation of enterprises. But that does not always solve problems, often different and bigger ones appear.

2. The impact of capital market on changing the state's role - restrictions in conducting of monetary, fiscal, and exchange rate policies

The last crisis has caused increased state intervention in many countries. Previously, in many regions of the world the role of the state was being reduced. State intervention was limited, state planning eliminated or reduced, the importance of market mechanisms increased. Functions of the state shifted from control of economic processes towards creating the conditions for competition and development. This is a consequence of the dominance of liberal theories. Despite the almost universal awareness that the market is unable to cope with all the problems of today's world, quite often the negative consequences of state intervention in the economy are emphasised. It is often indicated that, with state intervention, thing would go from bad to worse.

In the period of globalisation, the state has lost much of its traditional role. The state's role in shaping foreign economic relations has changed, for instance. Countries with open economies must have an economic policy that takes account of external conditions. Economic policies aimed at ensuring macroeconomic stability, low inflation, controlled budget deficit, balance of payments are restricted, as is the interest rate and exchange rate policy[4].

Investment decisions and directions of the flow of capital are largely contingent upon the macroeconomic situation of the country or region[5]. Very high mobility on modern capital markets means that governments find it increasingly difficult to conduct monetary policy. There may be situations where it will be difficult to determine the country of origin of the majority of financial institutions. As suggested by some, however, this is of little importance vis-à-vis the prospect of achieving maximum profits[6]. It is the capital having the choice that dictates conditions to which countries must adapt if they want the capital to flow in.

Mainly less developed countries, and less stable politically, must compete for capital. Their shortcomings (increased risk of the investment) must be compensated with lower taxes or lower social burdens. Low competitiveness of many economies and the accompanying high investment risk leads to an increase in interest rates on the debt issued by them (interest rate must compensate for high risk). The consequence is an increase in market interest rates and reduction of resources available to the companies (crowding-out effect). In addition, inflowing foreign capital leads to currency appreciation. In such circumstances, little is needed to bring about a sudden capital flight.

The opening of capital markets means that monetary, fiscal and exchange rate policy is subject to external verification. Lack of financial discipline, populist decisions and simple mistakes cause a loss of confidence of foreign investors. In such a situation speculative attacks can easily occur. The effect of the interest rate, the basic instrument of monetary policy, is increasingly conditioned by

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[4] *Globalizacja, mechanizmy i wyzwania*, edited by B. Liberska, PWE 2002, p. 34.

[5] Investors' decisions are largely affected by the assessments of the rating agencies, which critically evaluate monetary, financial and fiscal policies. Politicians' mistakes, irresponsible behavior, or public statements may destabilise financial markets, leading even to severe crises. Building investors' confidence is a lengthy process, while it is very easy to lose this confidence.

[6] On all the levels the systemic error underlying global integration makes itself evident: while the flow of goods and capital is globally available, regulation and control remain a prerogative of the nation-state. Economy devours politics. (H.P. Martin, H. Schumann, op.cit., s. 253).

changes in interest and exchange rates in foreign markets. Conducting monetary policy is becoming more complex. The effects of decisions made are less certain and more difficult to predict.

Nation-states increasingly lose control over financial flows and their own economic policies, while they become more and more subject to competitive pressures for further growth in deregulation and liberalization. According to Dahrendorf, incontrollable processes on the financial markets increasingly cause instability and chaos[7]. Under the influence of the iron grip of the new "Capitalist International" entire countries and their social structures waver in their foundations[8]. Threatening to flee, the capital enforces drastic tax breaks, subsidies or free billions in infrastructure. Alone, no nation is able to resist this pressure.

According to H. Martin and H. Schumann deregulation instead of state supervision, trade and capital market liberalisation, and privatisation of public enterprises became a strategic weapon of governments professing their faith in the market and of the international economic organizations controlled by them (IMF, WTO). Armed with these arguments, they joined the fight for freedom for capital, which continues to this day[9].

Most countries in the world try to attract foreign investors by creating a favourable environment for business. There are also those that are not conducive to entrepreneurs. According to a report by the World Bank, Poland is such a country. In 2009 it took the 153rd place among the 183 countries evaluated. A year earlier, it had a slightly better position – 142nd. The World Bank rating was mainly focused on tax issues: in Poland, the business operator had to pay 40 different taxes, as opposed to 12 in the Czech Republic and 16 in Germany.

Table 1. Examples of countries in the ranking

	Ireland	Denmark	Poland	Belarus
Ranking	6	13	151	183
The total tax rate	9	9	40	107
Number of tax payments per year	76	135	395	900
Time spent on tax formalities (in hours per year)	26.5	29.2	42.5	99.7

Source: World Bank Report, 2009.

Countries that until recently have sought to encourage domestic companies must stop these actions, because they distort competition by the unequal treatment of entities. At the same time wishing to attract foreign capital, they must support foreign investors, worsening competitive conditions for local businesses. Many entities that benefited from state subsidies, lost it, and instead had to face increased competition are often supported by their own states.

The crisis, however, led to emergence of various protectionist trends. Some countries have tried to link public assistance provided by them with requirements such as maintaining production in the country of origin at the expense of reducing production in other countries. France, for instance, gives a good example of such approach. Renault, which received 4 billion euros in state aid, was forced to desist from assigning the production of a new Clio to its plant in Turkey and to maintain production in France. That decision led to losses in Turkey, Spain and Slovenia. French Economy Minister also announced that the country might increase its stake in Renault to 20% (it was previously 15%) in order to increase the impact it has on the decisions of the group. Renault's production plans, in his view, are a political issue and the last word belongs to the President of France.

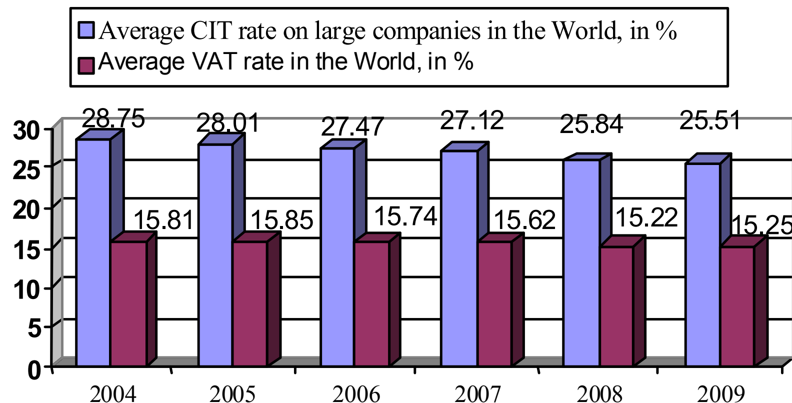
[7] R. Dahrendorf, *Nieświęte przymierze*, „Polityka” 1998, No. 9.
[8] H.P. Martin, H. Schumann, op.cit., p.12.
[9] Ibidem.

Increasing openness of the economies and growing capital flows make it difficult to have a fiscal policy uninfluenced by international circumstances. Fiscal policy affects investment decisions. It is increasingly difficult to determine where the tax liability arises when capital and production are on the move. Globally operating businesses have managed to involve many countries in the world into a "contest of tax systems". Since different countries compete to attract investment, they are left with no choice but cutting taxes. This leads to the governments are their autonomy in decisions concerning the tax rates, as they always have to take the reaction of the owners of surplus capital into consideration[10]. Not all countries lend themselves to this pressure[11]. It is worth noting, however, that tax cuts do not have to automatically lead to an increase in foreign investment. They are just one of many elements affecting the expected rate of return for investors. Various studies show that stability of regulations and legal protection for investors is more important for them, than some differences in taxes.

Many governments have reduced corporate taxation in recent years and introduced various investment incentives as well, and this has encouraged foreign investors to allocate capital in their country. The costs associated with it, however, were passed on to individuals. In many countries, taxes on individuals remain at high levels. A strong progressive tax led to the outflow of domestic capital and, therefore, Sweden for instance, has significantly reduced the scale of progression.

As is clear from a KPMG report, the crisis slowed down the decline in income tax rates on large companies. The average tax rate on income of companies decreased from 32.69% in 1999 to 25.51% in 2009. Some countries have recently even increased taxes. Lithuania raised the income tax from 15 to 20% and the VAT was raised in Ireland from 21 to 21.5% in Hungary from 20 to 25%, in Estonia from 18 to 20%, in Latvia from 18 to 21%, Lithuania from 18 to 19%.

Chart 1. Changes in VAT & CIT rates in the World



Source: KPMG.

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[10] President Chirac defined the entire financial sector as a vicious lot, and the broker caste as the „AIDS of world economy" („The Economist", October 7, 1995). Tietmeyer, Chief of the Bundesbank said in 1996 during the World Economic Forum at Davos, that most politicians still do not realise how much they are controlled, or even steered, by the financial markets („Frankfurter Allgemeine Zeitung", February 3, 1996).

[11] In some countries an opposite process may be observed. Poland is among the exceptions. Despite lowering the corporate income tax to a flat 19%, many other taxes and fees went up. The number of changes in the tax regulations only leads to the conclusion that no "sane" investor should ever invest here. Rapid changes in regulations make reliable analysis and investment risk assessment virtually impossible. Poland is becoming ever less friendly for both domestic and foreign investors, which is visible in various rankings.

In the 1960s and early 1970s in most developed countries the share of budget expenditure in GDP increased. Since the early 1980s the increase occurred mainly in continental European countries; at the same time this share declined in the U.S. and Britain. In Europe, the highest share of budget expenditures is in the Scandinavian countries (e.g. Sweden, approximately 60%) and lowest in Ireland (33%). In the 10 new EU member states this share is on average 42%[12]. At the beginning of 21st century in most OECD countries there has been a decline in the share of taxes and spending in GDP.

There are significant differences in the structure of budget revenues in each country. In Europe the main source of revenue is VAT and excise, and the United States, Canada and Australia - income taxes. The differences also apply to compulsory social insurance contributions charged to labour costs. In Europe they are higher than in the United States. The lowest premiums (less than 15%) are in China, India, Indonesia, and Brazil. The highest (above 35%) in Germany, Belgium, Hungary and Italy. Significant differences also exist in the structure of expenditure.

The tax system has a major impact on capital market development. Taxes influence investing entities, entities that seek access to financial resources, and financial intermediaries. Because of differences in taxation between countries, there is no level playing field. At the same time opportunities for tax evasion increase. Excessive fiscal stringency undermines incentives to save, invest and work, increases transaction costs and the level of risk associated with making and business[13]. There is, however, no automatism. At the beginning of the process of globalisation it was thought that this process would benefit mainly rich countries. Today it can be seen that less developed countries can also profit from this. The country that benefited most from globalisation is China. Until recently, it was often stressed that globalisation is a threat to fragile states, but for the efficient and disciplined ones it creates opportunities for faster economic development. In light of recent events this opinion should be reconsidered carefully. If we assume that a fragile country is a country that conducts irresponsible policies, as the U.S. in recent years do, then the opinion is still valid.

Investment attractiveness of the country significantly impacts investment risk. This risk is dependent on many factors. Macroeconomic performance, financial equilibrium, creditworthiness, access to bank financing, access to capital markets and stable regulations to protect the interests of investors, inter alia, are all important factors. For many institutional investors, liquidity of the portfolio understood as the ability to quickly exit from the investment in a situation of rapid deterioration of the situation in a given country or region, or due to increased spending and demand for free resources (e.g., the need for redemption of units discontinued by the funds), has the greatest importance. Little or nothing must be done to make the negative effects of an investment reveal themselves. By contrast, taking advantage of the opportunities usually requires effort, thought and consistent action.

As shown by past experience, one of the consequences of crises was an increase in the deficit in public finances.

Table 2 Central budget deficits relative to GDP

Country, year of crisis	Deficit a year before the crisis	The highest deficit (year)	Increase (- decrease) deficit
Argentina, 2001	-2.4	-11.9 (2002)	9.5
Chile, 1980	4.8	-3.2 (1985)	8.0
Colombia, 1998	-3.6	-7.4 (1999)	3.8
Finland, 1991	1.0	-10.8 (1994)	11.8
Indonesia, 1997	2.1	-3.7 (2001)	5.8

[12] J.W. Bossak, op.cit, SGH, Warszawa 2006, p. 256.
[13] Ibidem, p. 261.

Japan, 1992	-0.7	-8.7 (1999)	9.4
Korea, 1997	0.0	-4.8 (1998)	4.8
Malaysia, 1997	0.7	-5.8 (2000)	6.5
Mexico, 1994	0.3	-2.3 (1998)	2.6
Norway, 1987	5.7	-2.5 (1992)	7.9
Spain, 1977	-3.9	-3.1 (1997)	-0.8
Sweden, 1991	3.8	-11.6 (1993)	15.4
Thailand, 1997	2.3	-3.5 (1999)	5.8

Source: C. M. Reinhart, K. S. Rogoff, The Aftermath of Financial Crises, San Francisco, 2009.

Financial assistance by the International Monetary Fund and the World Bank was dependent on the fulfilment of a number of conditions including: lower inflation, reduced taxes, reduced budget deficit, reduced subsidies to enterprises, removal of regulations restricting the free market. These recommendations have largely led to reducing the role of the state. The outbreak of the crisis in 2008 brought about a curious effect: that those who until recently postulated diminishing the role of the state, began - rather recklessly - pumping huge amounts of money into the economy, not really thinking about the consequences. They wanted to stop what is inevitable anyway.

Decisions taken by various countries to reduce the impact of the current crisis are similar to those taken by Japan 10 years earlier. Monetary and fiscal policy instruments were used. The greater concern is rather the U.S. than European countries, because of the limitations set up in Maastricht.

Fight with the crisis has increased the share of public expenditure relative to GDP. In the old EU countries this ratio is now higher than in the countries of Central and Eastern Europe.

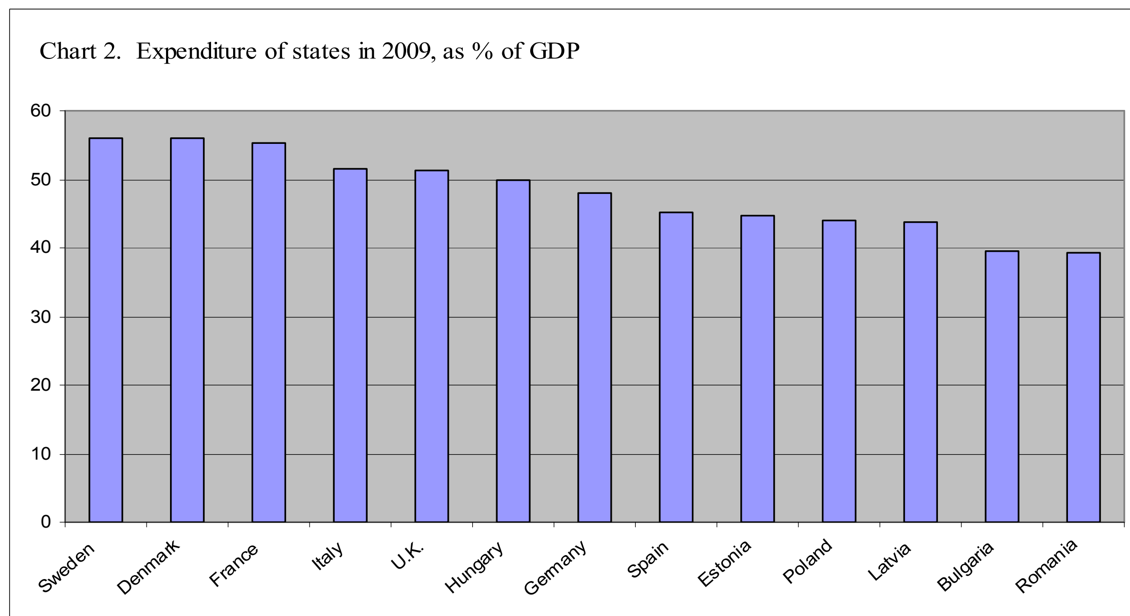

Chart 2. Expenditure of states in 2009, as % of GDP

Source: Eurostat.

The planned budget deficit of the United States in 2010 reached 1.6 trillion U.S. dollars. Over the last decade, government expenditure in the U.S. rose twice. Credit rating agencies lower the ratings of more and more indebted countries (Greece, Portugal and others). **Growing budget deficits may lead to a global fiscal crisis**.

One of the major questions that arise here concerns the fairness of spending billions of dollars on rescuing reckless investors and companies, who stood on the verge of bankruptcy. Supporters of this approach argue that it protected the world from a far deeper crisis, saved jobs, etc. Opponents indicate that no problem has been solved; only time was bought. The increased debt carried by states will be an enormous challenge (burden) in coming years. According to prof. S. Hanke the fatal reaction in Washington has changed, "a painful but short-lived recession into, perhaps, a several years long permanent crisis[14]. In his opinion, in the absence of government support the market alone would solve the problem. Unprepared and chaotic moves, and making people scared, undermined confidence in the market and the crisis deepened. Aid extended by the government to insolvent borrowers could lead to even greater problems (increase in the deficit, internal debt, inflation). By helping banks, insurance companies and automotive industries the government put itself in a position, that will make it difficult to refuse assistance to individual borrowers, who can not afford to repay the growing loan instalments.

Looking at various measures adopted in recent months (e.g., "injecting" 130 billion U.S.$. into AIG), one can have doubts about the effectiveness of such actions. It is certainly not conducive to reducing systemic risk[15]; to the contrary, systemic risk is increased as companies are encouraged to behave just as before. One could say that AIG is an institution that is too big to fail. If, however, such institutions are not allowed to fail, excessive leverage, or excessive speculation, will not be reduced in the future.

The negative experience with state intervention has led many to conclude that the lesser the role of the state, the better. It does not appear, however, that such a conclusion is fully justified[16]. Please note that the absence of state in the economy could be as damaging as an excess of it[17]. In view of increasing costs and risks associated with globalisation, there is a need to increase the role of the state in order to decrease the adverse effects of this process. In the economy, when the state is omnipotent, as well as when its role is unduly limited, anarchy, risk, and transaction costs increase and the economic activity of society is reduced[18]. If state intervention helps to increase accumulation, employment, productivity, entrepreneurship and innovation, then the country does not limit economic freedom, but increases it (for example, Japan after 1949). The state should not substitute for the market, but to steer (regulate) it in the direction of boosting entrepreneurship and structural change[19].

In my opinion, state support was necessary, but poorly executed. Nothing was done to eliminate at least some irregularities. Even a well thought out support, but carried out by only one country, is ineffective. Additionally, please note that administering the medicine to one segment of the economy may move the problems into other segments. **The attempt was to fight only the effects, not causes**. Effects of these activities are already visible. The speculative bubble begins to grow again. Managers benefiting from state aid continue to pay themselves huge bonuses, as if there was no crisis and nothing happened. Government action is, for them, an incentive to repeat

[14] „Rząd zawsze może zrobić coś głupiego" („The government can always do something stupid"), Gazeta Wyborcza, November 17, 2008r.

[15] The AIG Group issued hundreds of billions of dollars of mostly unsecured Credit Default Swaps (obligation to repay debt due to the second party to the transaction).

[16] „In contemporary capitalism the state is an active participant of economic processes everywhere, and to a greater degree than in the past, and in countries aiming to develop quickly the need for such activity is particularly strong. This is not contrary to market economy principles". – Z. Sadowski, *Polityka długofalowego rozwoju kraju a akcesja do Unii Europejskiej*, Warszaw 2002, p. 7.

[17] H. Chołaj, op.cit., p. 422.

[18] These are the conclusions of the World Bank (Word Development Report 2001, *Building Institutions for Markets*). F. Fukuyama has a similar approach, *Budowanie państwa. Władza i ład międzynarodowy w XXI wieku*, Rebis, Poznań 2005.

[19] J.W. Bossak, op.cit., p. 40.

what they did before the crisis. To simplify the problem, one could say that no matter what they do, they will still get their bonus. Only the paymaster changes.

The state has an important role to play in the economic and social development. However, the scope and direction of the impact of the state must change. The state should be more effective and less expensive. An efficient state[20] is needed, inter alia, to introduce regulations and institutions that will allow for more appropriate market development and improving welfare of the population. The state is necessary to implement appropriate foundations for the market. The absence of such foundations increases the uncertainty and increases transaction costs.

3. Institutional determinants of capital market efficiency – actions of the state to limit agency costs

The economic system of the country is part of the institutional system of state[21]. Various institutions are the foundation of order and social harmony. The modern economy could not function effectively without civil law, legal protection of creditors, regulation of companies, etc. However, the excess of the institutions (the state) may limit the freedom, activity and entrepreneurship. Institutions define the limits of acceptable behavior, define the limits of the economic game and enforce compliance at the same time.

The task of state institutions and public entities in the economic sphere is primarily to ensure the protection of property rights, freedom of economic activity and competition, promoting entrepreneurship, growth, employment and economic equilibrium[22]. The development of entrepreneurship depends on the degree of openness or restrictiveness of the law and the degree of compliance. Properly operating institutions created by the state are conducive to the reduction of transaction costs and risk. The operation of the businesses generates costs of acquiring information, of ensuring transparency, promotion costs, and other costs related to the economic system[23]. High transaction costs occur when institutions perform poorly.

Determination of an adequate role of the state is one of the most difficult problems that arise in the process of globalisation[24]. The macroeconomic policy is a very important issue; it should be shaped so as to foster economic growth. The budget deficit and inflation must be reduced. Whenever a deficit occurs, it is important how it is financed. In constructing the budget, it is of paramount importance to have the share of fixed expenditure not too high. This increases flexibility. A budget should also include off-budget operations. This will make better assessment of government finances possible[25].

In discussions on the role of the state, demands appear to increase or reduce its role. Such an approach leads to many misunderstandings. One should rather focus on the efficiency of state,

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[20] It is important to note, that there is a difference between the normative and the positive role of the state, or – to put it otherwise, between what the state should do to create conditions increasing the welfare of a society, and what it in fact does. (R. Musgrave, *The Theory of Public Finance*, 1959). The supporters of an increased role of the state see the normative role, whire their opponents are likely to look at the problem from the point of view of the positive (or rather, negative) role of the state. Looking at different countries trying to adapt to new challenges one has the impression, that the problem lies not with the lack of possibilities, but with the lack of willingness to adapt, combined with swimming against the current.

[21] J.W. Bossak, op.cit, p. 19.

[22] Ibidem, p. 23.

[23] K. Schenk, Economic Institutions and Complexity, Structures, Interactions and Emergent Properties, „Journal of Evolutionary Economics” May 2005, Vol. 15, p. 13.

[24] H. Chołaj, op.cit. p. 424.

[25] Poland is, again, a negative example. Instead of concentrating on the sanation of public finance, the entire effort goes into activities only apparently reducing debt. That is i.e. the underlying reason behind the proposals to grab a part of resources from pension funds and transfer them to state social security. Instead of reforming the agricultural pension system, very disadvantageous actions are proposed.

rather than its strength. It is often indicated that the resources limited as a result of tax competition do not allow the state to play an active role. Many actions, however, do not require, in my opinion, additional funds. Often more efficient use of resources already held suffices[26].

A new market order may be built only when the market and competition will work under a certain institutional framework (legal and ethical rules). Markets must meet certain conditions. Please note, however, that coordination must not be excessive. The state should reduce any imperfections, both its own, and the market's. The role of the state must be complementary with the role of the market.

In considerations concerning the role of the state, two basic functions are usually identified: operational and systemic[27]. The operational function relates to direct state interference in economic activity. Within the systemic function, the state serves as a creator, supervisor and manager of the economic system. Creating institutions which support the functioning of the market and enterprises, improving the quality of resources and capacity is most important. It is necessary to develop a long-term economic strategy. There is therefore no question of limiting the functions of the state, but only of a change in approach. According J.H. Dunning, the State should restrict the operational functions (be "leaner"), reduce red tape (be "flexible"), and take systemic actions (creation of new institutions and regulations).

When pointing to the weakness of the state in carrying out its stabilising functions, several causes are often given:

- delays in the monetary mechanism,
- crowding out effect,
- political business cycle,
- inflation expectations,
- real business cycle[28].

The problem is that there is a growing a gap between the increased role that the State has to play, and the possibilities of its fulfilment. The World Bank report on the world economy indicates the applicability of two-part strategy[29]:

- The role of the state should be adapted to the possibilities. Countries that are trying to do too much, having too small resources, often do more harm than good.
- The capacity of the state should be increased by strengthening public institutions. Effective rules should be introduced, arbitrariness avoided, and corruption fought.

The main impact of state should concentrate on regulations, especially those that limit the scale of operations, which are outside the sphere of the real economy, including excessive leverage and taking excessive risks. This should not, however, lead to excessive growth of the role of state, to unnecessary development of new controlling institutions. Solutions combining the good sides of the market with necessary state intervention where the market cannot cope should be sought.

Many statements on the causes of crises often point to the ineffectiveness of prudential regulations. This leads to the logical conclusion that these regulations should be changed (tightened). The majority of the proposals going in this direction. When regulating different areas

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[26] Public expenditure in OECD countries in the early 1970s stood at 32% of GDP, in 1990 rose to 41%, and in 1998 to 43%. The mean yearly GDP growth was 3.4% in the 1970s, 2.9% in the 1980s, and 2.4% in the 1990s. At the same time countries whose public expenditure did not exceed 25% of their GDP developed at a yearly rate of 6.6%.: A. Piński, J. Piński, *Belka pod nogami. Jak zniechęcano nas do przedsiębiorczości*, „Wprost", September 12, 2004.

[27] J.H. Dunning, *Goverments and Macro-Organization of Economic Activity*, w: *Goverments, Globalization and International Business*, New York 1977.

[28] A.Lipowski, Ekonomiczna zawodność państwa-krytyczna analiza ujęcia antyetatystycznego, Ekonomista 2/2002, Warszawa, p. 170.

[29] *World Development Report 1997: The State in a Changing World*, Oxford University Press for the World Bank, New York 1997.

of market activity it should be borne in mind, however, that regulation turns off the natural market forces. And when these rules fail, it is often proposed that further regulation be introduced. Such an approach is, in my view, questionable, and for a number of reasons. First of all, causes of the crisis are much more complex. Second, a number of attempts to tighten restrictions proved ineffective (new instruments to circumvent new regulations were devised). Thirdly, it leads to various adverse effects (reduction in capital inflows, or increase the cost of capital).

The basic problem boils down to the fact that a number of specific solutions currently proposed were already attempted. Problems arising in different countries resulted in the imposition of various restrictions on the movement of capital. However, this did not bring the desired effect. This concerns for example the so-called Tobin tax, the taxation of short-term capital market operations, or prohibition or restriction on short sales. Attempts to administrative reduce speculative capital flows[30] (restoring restrictions on transactions previously liberalized), undermined confidence in the authorities' policy, increasing the risk in this country. This resulted in reducing capital flows, while making it difficult for companies to access capital, and increasing the cost of its acquisition. The new role of the state certainly cannot be confined to the role of caretaker[31] of the new order, if only because the new order does not yet exist. Swift action is needed.

In my opinion, improving market efficiency and reducing the negative impact of the market on the functioning of the businesses requires an active role of the state, but you have to do it in a thoughtful and comprehensive manner (taking into account the different situations and reasons.) Do those, who have to decide about these changes, have enough courage and wisdom to admit that they are accomplices who led to the present situation? A brain is needed to admit this, to realize what the real causes of instability are, and what are the consequences of your actions. Can regulators, while attacking speculators and shortsighted managers and capital markets, break away from populism and short-term political objectives? A good example of such populism is, for example, the attempt to administratively reduce excessive salaries of managers. These salaries, undoubtedly in many cases, are obscenely excessive and unrelated to the results, but the currently proposed way of resolving this problem is in my view inappropriate. The main problem is not high salaries, but excessive risk-taking incentive, and detachment of the motivating system from the long-term results. There is no doubt that often the salary and bonuses are obviously too high, as evidenced by the many previously described examples. It's hard to imagine, however, that the state defines the level of wages and the amount of bonuses paid. Punishing anyone who got a bonus of more than 25 thousand euros or pounds is not the solution. We must look for systemic solutions. Proposals to place "caps" on wages appear often, but I do not think that it is an appropriate solution[32]. Another example of such populist measures such are the so-called "parities" in the supervisory boards. In 2003 Norwegians introduced a requirement, that women should constitute 40% of supervisory boards' members. Similar solutions were adopted in Spain, but they will not be in force until 2015. The third country is France, where companies were given six years for the

[30] For example, in Chile, mandatory non-interest bearing deposits equalling 30% of the value of financial investments made there by a foreign entity were introduced. Another limitation was the requirement that the capital flowing to remain in this country at least a year. In some countries, using tax preferences for capital gains, these are restricted only to long-term investments.

[31] Neo-liberals represented by Milton Friedman and Friedrich August von Hayek believed that the state should only be a night guardian. There is a certain evolution of views, particularly with regard to Friedman.

[32] Poland has considerable experience in restricting wages of boards in state-owned firms. As these wages are not linked with the size of companies, the difficulty in the management, or results achieved results achieved, the jobs often go to losers, who are unable to find better paid positions in private companies. Different ingenious methods to circumvent these restrictions have been devised. Another anomaly is that the board members of such companies may earn significantly less than their subordinates who are not covered by this law.

introduction of “parity”. If you do not do this, all the decisions of boards will be void. At least one woman has to appear in every council at the next exchange of the boards.

A basic condition for the effectiveness of any solution is to understand the causes of irregularities. G. Sorman argued that the deregulation of financial markets brought about mainly an increase in speculation and therefore there is a need to establish rules according to totally new principles[33]. This thinking does not give opportunities to develop appropriate solutions. One-sidedness in the approach to the role of capital market leads nowhere. It is clear that the capital market is imperfect, and the state as a regulator of this market is imperfect too. Just as different solutions on the capital market led to a crisis, the state has also participating in provoking it.

The problem is also that many borrowers and investors, especially individual have a very low level of knowledge. Many of them are simply illiterate, and do not understand what they sign. Very often they do not read the documents they sign. A number of vendors take advantage of this. The behavior of these sellers is unethical, but charging them with sole responsibility is not appropriate. Those who want "a free ride[34] also must bear responsibility for their mistaken decisions. I am fully aware that sometimes it is very difficult to read a large number of annexes to the contracts, the small print, or very extensive tables of fees and commissions. However, this may not be the basis for shifting responsibility to others.

The European Commission has concluded that such investors should be given extra help and issued the MiFID directive. Under this directive the seller of financial products should be assess the investor profile in a detailed survey, and determine the suitability of the service proposed. The investor takes the final decision anyway. Will this change the situation significantly? I do not think so. Those who mindlessly invested will continue to do so. Without imposing liability for the decisions taken at three levels (managers, state and investors) the volatility in capital markets cannot be reduced.

Below I present schematically the causes of instability of capital markets. Creating the conditions for a safe capital market depends primarily on creating the basis of stable functioning and development of individual countries. Capital market development requires the active role of the state. This applies mainly to establishing specific regulations to ensure the safety of this market. The following factors have a great significance:

- regulations defining the principles and procedures of public trading in securities (regulations concerning the preparation of prospectuses in public offerings and the scope of the periodic information, regulating the secondary market and settlements)
- institutional arrangements, to ensure fair trading and competition (the licensing of stock exchanges, brokers, investment advisers, investment funds)
- actions to ensure the smooth functioning of the securities market and protect participants of this market (a system of civil and criminal liability)
- confidence in the public trading of securities on a given capital market.

Several areas of activity may be indicated. The first priority is to create conditions for better access to reliable information and introduction of appropriate corporate governance. This depends primarily on creating appropriate regulations and institutions to disclose important information, providing equal access to information, implementing international accounting standards and protecting the interests of different shareholders. Protection of small shareholders must be increased, corporate management improved, international accounting standards - disseminated. Consideration must be given to the issue of determining the values of individual assets and their impact on financial statements. An important area, which also should be regulated, is the credit

[33] G.Sorman, Kryzys dopiero przed nami, Tygodnik Idei, Europa Dziennik, 9-10 May 2009

[34] This type of wording should probably not be found in this work, but I was provoked by the statement of one of the professors of economics, who often complained that "the banks are doing him in." It is interesting, whether when the products offered by banks and other financial institutions could achieve above-average profits, their customers also feel "done in".

rating industry. These regulations should encourage transparency in their functioning. Not just the rating itself is important, but also the way it is determined.

The second line of action concerns adequate supervision. The financial sector must be properly supervised. This would make early detection of threats and countering them effective. Erroneous or insufficient information about the financial position of enterprises[35] may delay the market's reaction. Delay increases the violence of the reaction.

CRISIS MAP

[35] Companies should publish financial statements, verified by independent auditors.

I. REASONS OF INSTABILITY OF THE CAPITAL MARKETS

1. PRIMARY CAUSES

Conflict of agency (costs of agency)

- **change in ownership structure** - Separation of ownership from management - acceptance of excessive risk-taking by managers due to lack of responsibility (distorted ratio of risk to rate of return), shortening the investment horizon, short-term increase in the company value at any price
- **irresponsible actions of state** - The state can also be seen as an agent. It is a specific agent. However, states have enormous resources at their disposal, often not very well managed and are not generally liable for its actions. The State does not function well as a business owner and regulator. Pursuing expansionary economic policy stimulates excess demand, leading to overvaluation of securities and real estate and speculation

2. SECONDARY CAUSES

- **technical progress** (Internet, computerization, telecommunications) - improved access to information facilitated investment decisions
- **liberalization** - facilitated movement of capital on a large scale
- **development of capital market**:

- Development of institutional investors administrations with enormous resources aimed at short-term gains

- The dynamic development of financial instruments to facilitate the creation and movement of capital (leverage is easier) and the relocation and reduction (often illusory) of risk

II. ATEMPTS TO SOLVE THE PROBLEMS

1. ATTEMPTS TO DATE (REDUCING COST OF AGENCY)

- **Market** - Aggressive incentive systems
- **State** - Regulations (prudential, concerning information disclosure, protecting the interests of different shareholders
  - Providing financial support to vulnerable subjects (socializing losses, spreading

responsibility, encouraging similar actions in the future)

2. **BASIC DIRECTION OF PROPOSED CHANGES**

- **Better accountability (Eliminating the asymmetry of responsibility)** of managers and other capital market participants for their incorrect decisions (appropriate actions of both market and state)
- **better regulation** concerning the protection of investors and the transmission of reliable information, coupled with effective enforcement (appropriate action of the State)
- **the creation of supranational supervision** (Appropriate action of groups of countries and international organizations)

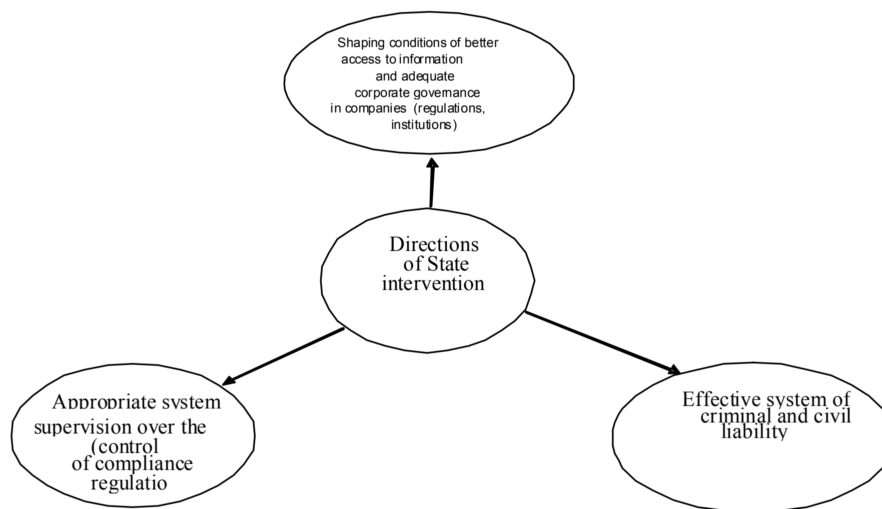
A major factor in the development of each country is an appropriate legal and institutional system that protects investors (Corporate Governance.) The possibility of raising capital by companies in foreign markets depends on, inter alia, reducing the risk of expropriation of shareholders by managers. Research shows that the development of legal protection of investors is an important factor in the development of financial markets. Outside investors financing a company are usually concerned that the benefits they expect may not materialize, because the main shareholders and managers can expropriate them (by, for instance, "stealing the profits" selling production or assets at depressed prices to other companies controlled by them[36]). In such a situation money will not return money to investors, but increase the benefits of insiders (managers and major shareholders)[37].

Better protection[38] makes investors willing to pay more for domestic assets. They pay more because they believe that better legal protection will result in a higher return, higher gains on interest or dividends. Securities prices grow in such circumstances[39]. Weak protection, on the other hand, increases the risks of expropriation of shareholders by entrepreneurs who control the company[40]. Empirical studies therefore confirm that better legal protection of shareholders results in a higher valuation of the assets of enterprises.

Not only relevant legal regulations are important, or the creation of appropriate institutions, but also and above all, adequate law enforcement. The third priority concerns, therefore, an effective system of criminal liability and civil liability.

Previous experiences in various countries show that there were some shortcomings in all these areas. However, in my view, the greatest, problem is the lack of an effective system of civil and criminal liability. This includes two aspects: responsibility and efficiency in its enforcement.

Chart 4. Main areas of state activity in increasing effectiveness of capital markets.



Source: Own work

[36] Other forms of action to the detriment of small shareholders may be excessive wage, or the hiring of family members or friends who do not have the appropriate qualifications.

37] R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, *Investor Protection and Corporate Governance*, P. 2

[38] The literature indicates that in countries whose legal system is based on civil law, there is greater state intervention in economic activity, and consequently weaker protection of private property, than in systems based on common law.

[39] It is worth remembering especially when discussing privatization and valuation of companies.

[40] R. La Porta, F. Lopez-de-Silanes, A. Shleifer, R. Vishny, Investor Protection and Corporate Governance, Department of Economics, Harvard University, Cambridge, 2000.

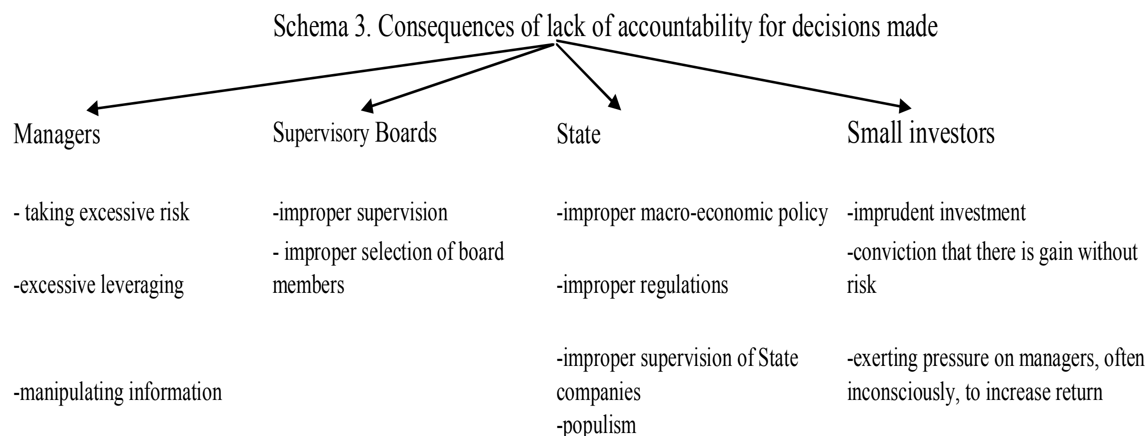
As regards the scope of a manager's responsibility, I would point to two basic problems. The first concerns the limitation of liability to direct losses caused by their decisions. And this losses should not be seen as deterioration in the financial results of the company only, because in such a situation a manager can at most lose his job. Responsibility usually occurs only when there is the so-called intentional act, or deliberate violation of specific provisions. Taking excessive investment risk and potential losses due to this do not cause negative consequences for managers. **There is an obvious asymmetry of responsibility**. In the event of bad decisions shareholders lose capital invested by them, and managers at most lose jobs. When, on the other hand, they take the right decision, they get a huge bonus. Is it not possible to implement a solution whereby the deterioration of the results leads to giving back their earlier bonuses? In this situation, their inclination towards risk would be much lower, they would carefully approach the different financial instruments.

The managers' incentive systems should therefore be so modified, as to encourage them to take long-term action. This can be achieved through:

- withdrawal of "golden parachutes" and guaranteed bonuses paid in the case of dismissal for poor performance or violation of law,
- reducing the amount of bonuses in relation to the basic salary,
- deferred bonuses related to future results,
- possibility to demand repayment of the bonus, when future results turn out to be below expectations (extension of the assessment period)
- annual bonuses in escrow accounts, which may withdrawn in case of losses.

The State should establish regulations to facilitate or even impose the obligation to apply such solutions. The criterions of selection and responsibilities of members of supervisory boards must be also changed. This could result in that fewer politicians and public officials, having neither qualifications nor motivation for proper supervision, and interested only in the easy extra income, would apply for seats in the supervisory boards.

The second problem concerns the scope of entities subject to this responsibility. Undoubtedly, the negative role of the managers is not subject to any doubt. But it must be kept in mind, that the State, investors, and borrowers, are also responsible. Too easily and too often we release these other parties from liability. Such an approach makes it difficult to introduce various solutions to eliminate anomalies in the capital market. **Frequent changes in regulations (taxes) affect the investment perspective shortening it, and increase speculation that is leading to instability of capital markets**.



Schema 3. Consequences of lack of accountability for decisions made

Source: own.

Enforcement of liability, set aside concerns about its scope and subjective, leaves much to be desired.

Activities to increase the competitiveness of enterprises are important. One can speak about a new concept of economic policy of the State in conditions of globalisation, which is designed to shift the emphasis from direct government regulation of economic mechanisms, to creating conditions for increasing competitiveness[41]. Businesses gain more from reducing red tape, increasing the transparency of regulations, limiting the amount of changes in the rules, than from obtaining new subsidies, especially when, moreover, resources are becoming scarce. Many countries have taken active policy aimed at increasing the competitiveness of enterprises and economies. Within the framework of macroeconomic policy, measures are taken to shape the structure of the economy and its exports in line with trends of changes in global demand. The opening of the national economy to the external markets offers opportunities to increase economic growth in the long term. Raising the international competitiveness of enterprises should be supported, i.a., by the expansion and maintenance of modern infrastructure. Developing economies and businesses increasingly require a higher level of applied technology and increasingly high qualifications. The state plays an important role in their development.

Other activities are related to the creation of conditions for fair competition. I.e., monopolies in different areas of the economy should be restricted. An important issue is to reduce the size of companies. Situations, where firms are too big to fail should be avoided. Institutions offering safe instruments should be banned from carrying out activities with a high risk. Analysing the different solutions used previously we should, in my opinion, consider the regulations introduced in 1933 in the United States; I mean the Glass-Steagall Act, separating commercial banking, investment and insurance services. Such separation allows the development of appropriate regulatory instruments and separation of safe activities from the more risky ones (speculative, easily leveraged). This would reduce the negative effects of transferring the results of excessively risky actions to those who often over many years saved, for instance in banks in banks (not willing to take too high risks). The appropriate course of action is deposit insurance up to certain amounts. This will increase transparency and competition on the market. There is also a need to take action to harmonize tax systems. Such actions are taken by the OECD and the European Union.

Since excessive leverage, excessive risk taking, and manipulation of information are largely a consequence of the separation of ownership from management, putting in place measures that prevent excessive fragmentation of ownership should be considered, at least in relation to companies that raise equity in a public market. **Regulations that block the effective impact of shareholders on the company must be changed**. A striking example of the pathology occurring here is the opposition of the largest owner of Kraft, Warren Buffett (Owner of Kraft by a proxy, Berkshire Hathaway), against the takeover of Cadbury. The opposition turned out to be unsuccessful, since shareholders did not have real influence on such an important decision made by "their" company. In the U.S., already at the beginning of the 1930s regulations, which led to the growth of influence of the managers, often at the expense of the interest of owners, were introduced. The powers of the owners must be increased; regulations that increase the alienation of the owners of public companies have to be reduced.

Politicians are often reluctant to such changes. And they introduce laws, which deprive them of control over markets with reluctance[42] , forcing the transfer of control to financiers. Resistance also occurs on the part of families that control large corporations. Family property, which is prevalent in

[41] *The New Political Economy of Globalisation*, Vol I, Part II: *The State*, Ed. R. Higgott, Payne A., 2001.

[42] Such control may be effected, e.g., by large corporations. In many countries, politicians interfer in the management of the companies in which the state has a stake.

many Asian countries, is regarded as one of the factors that contributed to the financial crisis in the area. Managers of big companies, that are financed through internal sources or through affiliated banks[43] are also opposed to such reforms. This makes much of the bank loans go, in these countries, to several major companies, which hinders access to finance for small firms that could compete with large companies. The protection of foreign investors, while contributing to the development of capital markets and facilitating the funding of small businesses, is at the same time a major threat to the inefficient firms, which must lead them to block such reforms. It is often easier to use political influence to block the reforms than to take action to improve efficiency. Poor corporate management of such companies provides safe funding, secure policy and secure markets. They are therefore keen to keep the existing system[44]. Difficult start of many less developed countries, due to, inter alia, lower competitiveness, conditions the adaptation processes in a particular manner. This does not mean, however, that these countries are predetermined to be losers.

You cannot focus on regulating the names, you need to regulate risk. Restricting or prohibiting certain instruments (securitisation, short-selling) is not a solution, but ways to reduce excessive risk should be found. Moreover, the steps currently taken by the U.S. government do not solve any problems in my opinion[45], and only perpetuate the existing anomalies and accelerate the next crisis. Rescue (support) of private institutions by the state increases the risk of actions known as "moral hazard".

One must always remember that too much detail in regulations reduces the flexibility of the market. Action must be taken, for instance, so that reduced tax rates are accompanied by increased revenues for the budget, or at least not by a significant drop in these revenues. This may happen when the tax reduction is be accompanied by an increase in economic activity. This is not an easy task and there is no automatism here. The history of individual countries provides ample evidence that in some situations, tax cuts led to an increase in activity, but there are also cases where there was no such link. This is due to the fact, that investment decisions are conditioned by many factors, not just the amount of taxes.

It is not passive adaptation, as some suggest, to the demands of capital, that matters, but knowledge of mechanisms that decide about a specific behaviors of that capital· Capital movements, including speculation, are subordinate to the objectives of the owners of capital. Understanding the determinants of these processes will make it easier to adapt to them and benefit from opportunities associated with this.

The error of submission, long known in the economy still valid; rationality at the micro level is not the same as rationality at the macro level. Reflections on changes in the state's role can not be treated here as an argument that this error does not exist. This problem occurs all the time, in many cases even intensifies. The market alone will not solve this problem. Dilemmas relate only to how the state can help reduce market failures[46].

Due to the excessive regulation in the European Union, it will be harder to get out of recession. Ideas for additional regulation (increased control over banks, barriers to investment, protection of different industries by the state) have the potential to widen the gap between the EU and America in the future.

A greater government intervention in the economy may take such forms as in the U.S. (plan of Treasury Secretary Paulson), France under Sarkozy's leadership, or Switzerland. This third example is more market-friendly, more thought out. In Switzerland, before the intervention

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[43] C. Mayer *New issues in corporate finance*, "European Economic Review" 1998, No. 32, p. 1167-1188.
[44] R.L. La Porta, et al. ... Investor Protection, p. 25
[45] I am thinking long term. In the short term, you can talk about some of the apparent benefits such as slowing decline in production, the number of bankruptcies, etc.
[46] In this work, of course, the considerations do not apply to the market as such, but generally they are confined to the capital market.

occurred, authorities explained by what results they expect to achieve, what steps will be taken and when the State will withdraw from intervention.

In conclusion, it must be said that as the capital market develops, the state largely loses its ability to act. To attract capital, the state must submit to the requirements of capital. Taking action unfavorable to capital means that capital leaves (this is a kind of punishment). From this point of view we can say that the state loses its significance, because it may not take certain actions at will. Incompleteness of political and economic globalisation promotes the growing strength of the capital market. The flow of labor remains blocked, while capital is on the move. Despite these limitations of the States' ability to act, there are new trends and the impact of new challenges. Without the active role of the State the adverse consequences of development of capital markets cannot be restricted. These measures must however be carefully considered and subject to certain logic. It is essential to identify the causes of instability.

4. Incompleteness of globalisation - the need to create a supranational supervision

Widespread liberalization of capital markets led to the fact that these markets largely slipped out from any control. Economic globalisation is not accompanied by simultaneous globalisation in the political sphere, which causes that we can speak of the incompleteness of globalisation[47].

As already mentioned an important factor in the volatility of capital markets is taking excessive risks and information asymmetry. The inability of the market itself to eliminate these causes of weakness points to the need for greater regulation and supervision by the State.

Many point out, that a principal mean to combat the crisis is restructuring the regulatory oversight of securities market. There are some indications that it should be more systemic and flexible, so that it can respond more quickly if it appears that some measures introduced cause unintended consequences. The need for a systematic approach results from the interaction between international markets. Attempts to regulate the global flow at the local level proved to be ineffective. You can talk about "competitive speculative arbitrage," or competition between national regulators for foreign capital.

It is also indicated ever more often, that a new international financial architecture needs to be agreed, however, on a super-national basis. Already many years ago H. Kaufman proposed to create a global institution to exercise supervision over both commercial banks and non-bank financial intermediaries[48]. It seems that this will be very difficult, due to different interests and diverging views on these issues. In the meantime, extensive use of already existing international institutions is paramount[49].

One of the key problems is that, to date, no international actor that can identify the global targets developed. There are neither rules, nor institutions provided with adequate means to force market actors to comply with such rules. Any discussions on this issue reveal a huge conflict of interest in the global economy. A further asymmetry between the capacity of the state and expectations for coordination reveals itself also.

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[47] For more on this topic see works by W. Szymanski, who in addition to incompleteness in the political sphere also points to the incompleteness in the economic sphere, namely the lack of freedom of movement of labor and agricultural products. This is due to the protection of their interests by the highly developed countries.

[48] H. Kaufman, *Developing the West Global Financial Crises*, "Washington Post, 28/01/1998.

[49] Several institutions may be named, i.a.: Committee on the Global Financial System (CGFS), International Association of Securities Commissions (IAIS), International Accounting Standards Committee (IASC), Global Forum on Company Management,, standardized data system about the development of individual states (SDDS).

Although the institutions subject to supervision operate globally, each country has so far implemented financial supervision on its own. It happened also, that there were inconsistencies between the different national regulations. This resulted in that the foreign activities of financial institutions often slipped out of any control. Operating in various markets simultaneously created possibilities of distorting the picture of the financial situation of an institution. Additional problems are associated with tax havens, where supervision practically does not exist. This makes not only tax evasion, but also disrespecting prudential regulations, relatively easy.

Eliminating these problems requires the creation of supranational supervision that should have the right to review the activities of the entire financial groups, regardless of where their business is conducted.

Attempts to reduce the impact of crises often result in an increased state interventionism. Protectionism and state intervention in the economy grow, which greatly impedes the introduction of trans-national solutions. This suggests that such solutions should be introduced in more peaceful times, but unfortunately then the desire (compulsion) to introduce them is also much smaller.

Existing institutions - the World Bank and IMF are not sufficiently representative to obtain legitimacy necessary for global management. One of the lines of action is taking steps aimed at reforming the existing institutions in order to make them more efficient and reliable. This, however, requires a community of interests. Activities can be effective only if they give a global dimension. In the case of the IMF the main concern is its rather low acceptability, due to its record of activities. Assistance provided by this institution in many cases contributed indirectly to insure (reduce) the risk of the capital market. Investors expected, that should problems in individual countries arise, the IMF will come to their aid, and hence were willing to accept an apparently higher risk. I do not think, however, that Stiglitz was right when he argued that the IMF is not guided by the desire to assist such countries in trouble, and takes action that only allows highly developed countries to withdraw their capital[50].

The void caused by lack of adequate systemic solutions was partially filled by the creation of ad hoc agreements on cooperation between groups of countries, taking over the role of "steering committees in the world economy" (G7, G8, and G20)[51]. Several meetings, during which it was attempted to determine the directions of future changes, were held. G-20 summits took place in November 2008 in Washington and in London in April 2009. Also, very to the point, during these meetings it was admitted that the effectiveness of the proposed solutions requires the involvement of many more countries, not just the most developed ones. It should therefore be a G-192, but it's hard to imagine that such a broad forum could take any decisions.

Summit in Washington

Heads of G-20 states[52], at a meeting held in November 2008 in Washington pledged to take action in several areas ranging from greater market transparency, strengthening the control system, and ending with the reform of international financial institutions.

1/ improving market transparency:

- financial supervisory authorities are to cooperate with the private sector in properly implementing new accounting rules,
- requirements concerning the content of reports published by financial institutions on their financial condition will be tightened,
- supervision will ensure completeness and correctness of these reports,

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[50] J. Stiglitz, Globalizacja, PWN, Warsaw 2004, p. 28-36.

[51] J. W. Gołębiowski, J.W.Gołębiowski, Global Governance, Koncepcje-doświadczenia-perspektywy. Instytut Gospodarki Światowej, SGH, Warszawa 2008, p. 23-25.

[52] Forum affiliating industrialized countries and developing countries.

2 / strengthening the control system:

- system of financial market regulation should prevent the crisis from spreading to other sectors of economy,
- international rating agencies will be reformed, so that they can provide objective information to the market. These agencies will be subject to monitoring, and the obligation of registration,
- financial institutions should hold capital reserves, such as not to undermine confidence in the banking systems. The amount of a bank's capital will depend on the structure of its loan portfolio,
- a strong system of supervision of the liquidity of international financial markets will be created,
- a reform of bankruptcy laws applicable to international corporations will be carried out.

3 / market management:

- bank risk management procedures need to be strengthened. Financial institutions should improve internal controls,
- procedures to better manage liquidity will be created,
- protection of the markets from turbulence should be an objective of the banks, and therefore they should reform their management systems with this aim in mind,
- risk management systems in relation to structured products will be created.

4 / promotion of the integrity of financial markets:

- the main objective of the State is to protect investors and consumers,
- the threat to the stability of international markets will be eliminated, through increasing cooperation between national financial supervision authorities,
- fight against money laundering and financial terrorism will be expanded.

5 / reform of international financial institutions:

- Financial Stability Forum will be expanded and new members admitted,
- IMF should become a major center for the analysis of the current crisis and will develop appropriate conclusions,
- capital resources of the World Bank Group should be increased,
- credit markets will be more accessible to developing countries,
- Bretton Woods system should be reformed so as to correspond with the evolution of the global economy, the role of developing countries is to be raised,
- IMF surveillance over all countries will be strengthened, and more attention paid to financial sector,
- developed countries should increase their role in supporting economic growth in poorer regions of the world.

The summit final communiqué stated that, with deteriorating economic conditions around the world, there is a need for a broader policy response, based on a closer economic cooperation, in order to restore growth, to avoid a negative domino effect, and to support the emerging-market economies and developing countries.

Other regulatory areas discussed are:

1. Valuation of assets by the so-called fair value – valuation of assets at market prices, regardless of their degree of liquidity. Listed companies using International Financial Reporting Standards (IFRS) estimate the financial instruments (derivatives, bonds and others) at fair value. In the case of companies not complying with these standards valuation is based on historical value (the value of expenses incurred) The use of fair value causes unrealized gains (gains on valuation of assets) in the companies in good times, and during a crisis there are losses resulting from lower valuation. Losses from the valuation, when their level exceeds the value of equity, are the basis for the bankruptcy of companies, which significantly contributes to deepening the crisis. This is particularly true when, to cover losses, other assets

are sold quickly. Both valuation gains and losses are unrealized values, which show the differences between the historical costs of acquisition (construction) of assets, and their market value at the balance sheet. Gains and losses realized may vary significantly from the unrealized gains and losses (resulting from valuation). Valuations are subject to large fluctuations. Changes in the market are automatically reflected in the valuations. The use of historical prices, however, reduces the transparency of financial statements and makes it difficult to compare the financial situation of companies in different periods or to compare different companies.

2. Greater transparency of banks, private equity and hedge funds. These institutions, unlike the so-called public companies, have limited publication obligations. This reduces transparency and comparability.

In assessing the setting of different peaks, it should be noted that the root causes of instability of capital markets were not fully realized, and without this it is difficult to propose appropriate solutions. What was proposed is, in my view, incomplete and too vague, and as usual the problem lies in the details. It is difficult, on the other hand, to imagine that in a crisis situation, with so many conflicts of interest, such a group could come up with something more concrete. I do not think that these meetings could soon translate into practical solutions. Some changes probably will occur, but they will be insufficient to face the next problems. Again, there are demands to introduce a Tobin tax, but its implementation does not appear possible.

A significant change is a departure from the spirit of liberalism, which largely lost its monopoly (at least verbally). We must however add that blaming everything on neo-liberalism is wrong. Not neo-liberalism is the problem, but rather a weakness of market mechanisms. The market coordination is weak. Lack of accountability of decision makers, resulting in excessive speculative capital movements, and speculative bubbles, does not encounter appropriate market barriers or state regulations. **Market failures can be dealt with by appropriate state intervention. However, the weakness of states can not be solved by increasing the role of the state.**

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