Guest Editor Introduction: Debt Crisis and Financial Stability

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This special issue of the Journal of European Theoretical and Applied Studies is composed of three papers which were presented at the 2nd FinanDebt International Conference on "Debt Crisis and Financial Stability: Global Issues and Euro-mediterranean Perspectives". All the papers went through the journal's standart referee and editorial processes. The Conference was organized in Toulon (France) on 15-16 April 2014, by the LEAD (Laboratoire d'Economie Appliquée au Développement, Université de Toulon) and the CES (Center for European Studies, University of Kirklareli, Turkey) research groups, with the support of the Central Bank of the Republic of Turkey, the Istanbul Stock Exchange, and the Istanbul Chamber of Commerce. The Conference deliberations focused on monetary policy and prudential regulation, crises and post crisis, and the financing of growth and development, especially regarding the global financial crisis and its consequences for Euro-Mediterranean economies.

These different themes refer more generally to the patterns of instability and financial crises which are typical of the current state of world capital markets. Indeed, with the advent of globalization, meaning both instability of domestic financial systems and an extensive use of market finance, a short-term capital account constraint replaces the medium-term economic development constraint. Countries become more vulnerable to external and particularly liquidity shocks. Moreover, this submission of state sovereignty to the individual interests of a minority of market operators has increased market risks.

National frameworks of political, economic, financial and monetary regulations are *ineffective*. World capital markets become the main source of balance of payments financing, both for financing needs and exchange rates adjustments. In this context, financial crises, combined with currency crises in the case of twin crises, made the history of the last three decades.

Based on the typology of crises by Dornbusch (2001) who distinguished between "*old-style crises*", caused by real exchange rates distortions and external imbalances; and "*new-style balance sheet crises*" resulting from bank fragility, and by Eichengreen et al. (1995) distinguished between first, second ,and third generations crises, each type of crisis being theoretically explained by a specific model, we can define the scenario of the

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current Global crisis as a "fourth-generation" crisis (Gilles and Bastidon-Gilles, 2014). This "new generation" then would be a "third-generation" crisis resulting in a sovereign debt crisis, in the peculiar context of asymmetric information generated by technicality of financial innovations, controlled or even developed by banks themselves. In this context, the Global crisis is a banking system crisis, which is peculiar for three reasons. Firstly, this crisis originated in the failure of securitization, which led to a contagious contraction of liquidity in money and capital markets. Second, systemic contagion is not primarily linked with aggregated insolvency, but the illiquidity of, specially, unsecured money markets. Normally, deposits banks should enable credit to the non-financial sector in conformity with long term liabilities. Investment banks should provide market liquidity, that is to say contribute to a proper turnover, reduce trading fees, and thus foster market prices convergence to their fundamental values. If some of these banks are illiquid the smooth operating of these systems is disrupted. Thirdly and finally, public policies that were conducted to manage this illiquidity crisis have significantly deepened government deficits and debts, and in turn created the conditions of the Euro area sovereign debt crisis.

The *central role of liquidity* in this scenario is particularly obvious in the sharp increase in risk premia just before banks failures, or government defaults. This illustrates the fact that the Global crisis of 2008 and Euro area sovereign debt crisis of 2011 result from liquidity shortages, much more than from deteriorated fundamentals. Consequently both regulation of bank capital and fiscal policy rules regarding deficit and debt ceilings are inadequate or at least insufficient conditions.

The genesis of the global crisis is in fact threefold: innovation, deregulation and liquidity (Mistral, 2009). At the beginning of the story is a *typical pattern of financial crises*, based on an initial business euphoria phase. In the context of easy borrowing, economic agents use maximum leverage effects to increase their returns. Then, an *unprecedented technicality* of financial innovation, arose especially securitized assets and derivatives. The outstanding total of debt and equity securities and other financial assets held by banks was in 2009 four times bigger than world GDP. The outstanding total of derivatives instruments was almost twelve times bigger (Lubochinsky, 2009). In this context, credit risk has been relocated outside of the regulated traditional banking system. Opacity has been increased, resulting in a quasi-impossibility of tracking securitized (ABS) and repackaged instruments (CDO). Therefore, the volatility of capital markets has significantly increased, and contagion mechanisms were strengthened.

Indeed, global financial crises trigger off specific large scale amplification effects increasing the expected financial acceleration (Adrian and Shin, 2009). This amplification allows shocks to a single market to propagate through the whole financial system, leading to both fast and heavy drops in financial assets prices, and large increases in funding costs of non-financial agents (Blanchard, 2009). In this context, the crisis occurs in two steps. In the first step, the initial shock is transmitted to the interbank market. A generalized financial crisis follows. This crisis timeline, with a key role of the interbank market, is described for instance by Bordo (2008) or Freixas and Jorge (2008).

These special features of the recent crises, that is to say 1/ the identification of the nature and causes of financial and banking sectors fragilities, in conjunction with the funding of economic activity, and particularly of firms; and 2/ the analysis of institutional resources, in terms of prudential regulation, Central Banks action, and the possibility of a focus of monetary policy on these weaknesses are the subject of the papers in this special issue. The contribution of Claude Aline Zobo (University of Yaoundé II–Soa) refers to the second point (2/). The contributions of Mihovil Anđelinović, Tifani Protić and Margareta Maresić (University of Zagreb); of Zohreh Hajiha and Bahman Sarfaraz (Islamic Azad University), refer to the first issue (1/).

More specifically, Claude Aline Zobo, in her paper entitled "European Crisis and Sustainability of the CFA Franc Fixity to Euro", investigates, among others, the problem of the pertinence of a fixed exchange rate between the CFA franc and the euro during the present European crisis. The paper shows a negative impact of the European crisis on the real exchange rate (RER) and the misalignment of the CFA franc, and negative effects on the macroeconomic equilibrium of the zone. In fact, an aligned exchange rate is supposed to promote the twin goals of internal and external target of equilibrium. The results from simulation of reduced equations, derived from the dependent economy model are consistent with those already highlighted in the literature. Indeed, the outbreak of the Eurozone crisis tends to usher the RER appreciation and thus, uphold the misalignment of the CFA franc. This has a significant rippling effect on GDP growth and trade balance. One can therefore assume that the exchange rate policy of the CFA zone should be guided towards a fluctuating exchange rate within a threshold as a “honeymoon effect” to curb vulnerability of external effects and promote the alignment of the exchange rate.

Macroeconomic stability also depends on the funding conditions of firms, which are particularly uncertain in the context of a Global crisis (*cf. supra*) with high risk aversion in debt and equity securities markets, whatever the countries are, which is the subject of the other contributions, in the cases of Croatia and Iran.

The aim of the paper of Mihovil Anđelinović, Tifani Protić, and Margareta Maresić entitled "Venture Capital Financing of Enterprises in Croatia" is to explore the financing of small businesses in the early stages of their development given that the method and even the possibility of funding in seed, startup and early expansion stage are crucial for the realization of entrepreneurial ideas. Given the level of risk in these phases of the development of small businesses, entrepreneurs are faced with a small number of financing options that involve mainly their own resources and formal and informal venture capital (VC) funds. If it is assumed that development stems from new and innovative products, which are often just launched by startups and SMEs, then this method of financing is an important engine for the development of each country. The conclusions have been drawn on the basis of data collected through a survey of startup market in Croatia, through original interviews with business angels and companies that have received money from the VC funds, as well as on the basis of their internal financial reports. In Croatia, the venture capital market is still underdeveloped with the small number of projects financed by venture capital funds as evidence, mostly because of low levels of capital, slow systems, poor ecosystem for entrepreneurship development, lack of successful and professional people who become investors and lack of real VC funds that will continue to invest in further stages after the initial minor business angel's funding. The projects, in their early seed or startup stage can rely only on business angels as part of the informal venture capital market, while the formal one is mainly directed towards the less risky investments or public capital investments for the reconstruction and development of some already present companies on the market.

The aim of the paper of Zohreh Hajiha and Bahman Sarfaraz entitled "The Investigation of the Relationship between Corporate Social Responsibility and Debt Cost in Tehran Stock Exchange Listed Companies" is to measure the relationship between corporate social responsibility and cost of debt in 65 companies listed in Tehran Stock Exchange (TSE) between 2008 and 2012. Social and environmental criteria and effective rate cost of debt for long-term loans are used in order to measure social responsibility and cost of debt, respectively in panel data regression analysis. The findings show that there is no significant relationship between social responsibility and cost of debt in Iranian companies which are active in an emerging capital market. This could be due to the lack of low rate loans as a source of financing in Iran.

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