THE ROLE OF INFORMATION ASYMETRY IN THE OUTBURST AND THE DEEPENING OF THE CONTEMPORARY ECONOMIC CRISIS

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Abstract
An analysis of the outburst and deepening of the contemporary economic crisis that takes into account the information asymmetry is highly opportune. This point of view is strongly supported by the latter years' developments regarding this theory, which may be able to explain the current evolutions of the economic and financial markets. Thus, the paper argues that adverse selection and moral hazard played a key role in the evolution of the contemporary economic crisis and that its routs can be detected away in history. In this regard, we analyze the situation prior to the outburst of the subprime crisis in the U.S. and how it developed in a context of asymmetry information, fueled by the government's actions. Given the importance of certitude, quantity and quality of data and information and the way they are interpreted, it becomes crucial to isolate the role of information asymmetry. The paper shows that issues related to all these aspects are instruments of in-depth analysis that can explain the mechanisms of outburst, spread and, mostly, persistence for more than three years of the crisis.

Keywords: *information asymmetry, moral hazard, adverse selection, economic crisis, subprime lending*

Introduction

The difficult situation faced by the world economy since 2008 has been labeled, depending on the economic doctrine of those who have analyzed it, either as a product of markets' deregulation, perceived as an example of "market failure", either as the undoubtedly result of state intervention, through various mechanisms (such as monetary policies) or even through specially created institutions (named Government Sponsored Enterprises – GSE - like Fannie Mae and Freddie Mac). From the same perspective, the subsequent actions of the governments were considered either late, slow and not very harsh, either unnecessary or, worse, resulting in prolonging the agony of such markets. In all those circumstances, both views seem to ignore something that representatives of both major economic doctrines - the socialist and liberal one – agree upon: nowadays information represents a central element for any market (and is even more potentiated in the financial one), but participants performing economic transactions have access to it in varying degrees. This paper addresses the issue of asymmetric information and its contribution in the contemporary economic crisis. Thus, in this paper we argue that the current crisis has "enjoyed" the full effects of this economic reality, by analyzing its roots and the way it evolved. Also, we argue that the measures taken by the authorities in order to counteract it can be placed under the same uncertainty spectrum the asymmetric information theory has developed many concepts about. The paper aims at providing a different approach of the economic crisis, which can explain its violent and unexpected outburst, its domino development and its prolonged existence. Also, by focusing on the long-term effects of the measures taken, we argue that they can actually contain the seeds of a future economic crisis.

I. Contemporary theories regarding the information asymmetry

The theory of information asymmetry refers to the uncertainty caused by the fact that economic agents have private information about their products, information not available evenly and under the same format to third parties. The starting point of these theories is the negation of the first

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conditions of perfect competition, namely the transparency or the perfect information deferred to economic agents. Thus, according to traditional microeconomics, price is the one that transmits the information and it fulfills this role when it is flexible and freely created. However, the supporters of the theory of asymmetric information markets argue that there is no perfect information to all individuals. This aspect is reflected with different intensity in the various fields. As a result, there have been identified markets more affected by information asymmetry and others enjoying a higher degree of transparency.

The important influence of these ideas in the contemporary economic thinking is revealed by the internationally received attention, especially in recent history, reflected in the fact that the highest distinction in the field, namely the Nobel Prize, was given to representatives of the theory of asymmetric information markets. Thus, in 1996, the award went to the economists James A. Mirrlees and William Vickrey, who founded their theories on information asymmetry hypothesis. Further on, in 2001, the Nobel Prize winners were George Akerlof, Michael Spence and Joseph Stiglitz, representatives of the same school of thought. The 1996 winners took as a starting point of analysis the fact that the asymmetric distribution of information has important effects on economic behavior of individuals, meaning that those better informed can exploit this strategic advantage in their favor. The two economists, however, focused on how the consequences of information asymmetry can be countered by creating certain types of contracts and institutions.

From this point on, the analysis regarding the theory of asymmetric information targeted more and diverse fields. The presence of this perverse phenomenon has been identified in markets more and more different in terms of structure, actors, manner of organization, ranging from the goods markets to the financial–banking markets. It also has a significant impact on areas like tax systems or economic policies. It is the merit of the 2001 winners of Nobel Prize the identification of the presence of asymmetric information phenomenon in various forms, in almost all economic activity.

Among the most important concepts currently used in the analysis of asymmetric information markets and also necessary in identifying the role that this element played in the gear of the present economic crisis, are the adverse selection and the moral hazard.

I.1. Adverse selection

The effects of information asymmetry are also reflected in the way the products and services are traded in different markets, a situation known in economic theory as adverse selection. The concept was put forward by the 2001 Nobel Prize Winner for Economics, George Akerlof, in an article[1] which argues that the existence of incomplete information regarding the quality of the products traded on the market generates, through the phenomenon of adverse selection, leads to an inefficient allocation of resources on that market. The adverse selection (sometimes referred to as the lemon problem), arises from the inability of traders/buyers to differentiate between the quality of certain products. The example used by Akerlof in order to demonstrate the effects of adverse selection is that of the second hand car market, in which a trader holds product information that the other buyers/sellers in that market lack. He thus operates at a comparative advantage as the other market players cannot tell if their product is a 'lemon' (poor quality car). Consequently, there is a risk involved in purchasing the good based on quality expectations. While the lower price buyers are willingly assuming this risk, traders selling quality cars do not desire to sell at such a low price. There are three components to this theory:

(1) there is a random variation in product quality in the market

(2) an asymmetry of information exists regarding product quality

(3) there is a greater willingness for poor quality car sellers to trade at low prices than higher-quality owners.

[1] George Akerlof, "The Market for Lemons: Quality Uncertainty and the Market Mechanism", *The Quarterly Journal of Economics*, No. 3, Vol. 84 (1970): 488-500.

Insurance, credit markets and financial markets are areas in which adverse selection is also important. These aspects were addressed by D. Jafee and T. Russell, who developed a model[2] that presents the rationalization situation in which all applicants receive loans with a value lower than the one desired, at a given level of interest rate. Two other economists, J. Stiglitz and A. Weiss, have developed another model[3] which shows that rationalization is reflected in the fact that some applicants are rejected even if they do not differ by other applicants who are credited by the lender.

Another paper that constitutes an important basis to explaining how asymmetric information - and, respectively, adverse selection - has contributed to the financial crisis and, more specifically, to the subprime crisis is *"The Allocation of Credit and Financial Collapse"*[4], in which the author, Gregory Mankiw, discusses the chances of government intervention to improve the equilibrium conditions in the credit market.

I.2. Moral hazard

Also known as moral risk, the concept of moral hazard has been identified, initially, in insurance contracts, where it was empirically found that an individual or group, who are insured against risk tend to face more often that risk situation than individuals who are not insured against it[5]. The concept was then expanded, referring more generally to behavioral changes caused by imperfect information regarding subsequent actions induced by a contract[6].

Initially seen as an ethical or moral issue, the concept of moral hazard has evolved precisely from the inability of these views to explain from an economic point of view the consequences of the existence of this phenomenon. Empirical research led to practical conclusions, that allowed defining the concept in a form much closer to tangible reality. Analyzing individual behavior, some economists, such as Mark V. Pauly[7] or Gary Becker[8], concluded that moral hazard represents a situation where the intensity of the actions of the insured to protect themselves against the risk is being reduced. This is due to the difficulty of the insurer to observe this type of behavior and to act accordingly when the value of the contract and the insurance premium are fixed. A definition that describes more accurately the situation created by moral hazard is that regarding the increase in consumption of an insured service as a result of reducing the price paid by the insured for that type of service. The insured is basically subsidized by the insurance policy and continues to spend for that service even after the marginal benefit would have fallen below marginal cost. The revenue deficit resulted from such a conduct is covered by the insurance policy[9].

Other researchers have taken this concept further, broadening the application field also outside the insurance market. This way, a complex definition of the phenomenon of moral hazard emerged, namely “that behavior, economically rational, which occurs when there is a risk (hedged by

[2] Dwight Jaffe and Thomas Russell, “Imperfect Information and Credit Rationing”, *The Quarterly Journal of Economics*, Vol. 90 (1976): 651-666.

[3] Joseph E. Stiglitz and Andrew Weiss, “Credit Rationing in Markets with Imperfect Information”, *American Economic Review*, no. 71 (1981): 393-410.

[4] Gregory N. Mankiw, “The Allocation of Credit and Financial Collapse”, *Quarterly Journal of Economics*, no. 101 (1985): 455-470.

[5] Herbert G. Grubel, “Risk, Uncertainty and Moral Hazard”, *The Journal of Risk and Insurance*, Vol 38 (mar. 1971): 100.

[6] George L. Serban-Oprescu, “Contribuții teoretice la dezvoltarea conceptului de informație în ştiința economică”, (PhD diss., Academia de Studii Economice Bucuresti), pg. 126.

[7] Mark V. Pauly, “The Economics of Moral Hazard: Comment”, *The American Economic Review*, Vol. 58, No.3, 1st part (Jun 1968): 531-537.

[8] Isaach Ehrlich and Gary S. Becker, “Market Insurance, Self-Insurance and Self-Protection”, *Journal Of Political Economy*, Vol. 80 (Jul 1972): 623-648.

[9] George L. Serban-Oprescu, “Contribuții teoretice la dezvoltarea conceptului de informație în ştiința economică”, (PhD diss., Academia de Studii Economice Bucuresti), pg. 127.

a third person) that an unforeseen event could occur, resulting in ulterior behavioral changes, not detectable by the third party".

II. The premises and the context prior to the contemporary economic crisis

II.1. Government conduct - element generating moral hazard

The supporters of the classical liberalism, but also many journalists[10] supporters of this thinking current brought into discussion the issue of moral hazard created through states' interventions aimed at saving various financial institutions from collapse or reviving the economy faced to a bearish trend.

The leading economists of information asymmetry theory consider that the coverage by a third person of a particular risk determines subsequent behavioral changes of those who are affected by this risk. More specifically, the existence of negative effects in case of a certain event determines the individual to act in such a way as to minimize the risk of occurrence of that event. When these effects are borne by another person, it is perfectly rational, to economically assume that the person threatened by the risk is no longer interested in avoiding the occurrence of that event. This behavior results in increasing the probability that the event would occur. Under this circumstance the person who took the risk will be affected.

By extrapolating this concept, the governments' intervention in the contemporary crisis, through the numerous aids granted to credit institutions and to large companies working in various industries, such as automotive or banking, altogether with packages for supporting their national economy, create a dangerous precedent. Therefore, the idea that the state will intervene if such a situation occurs in the future is induced in the markets.

Moreover, the phrase "too big to fail" is becoming more and more used, which means, contrary to most expectations, not that the regulations in this area will prevent such situations to occur in the future, but that large corporations, providing constant cash flows towards a country will consider the government as a "safety net" for their actions. This results in alleviating them from a prudential behavior.

Another problem that arises in this case is that not only the one who takes the risk will be affected. It is debatable in this case the complex system that allowed amounts of hundreds of millions of individuals to be channeled to rescue a few thousand and assume their misjudgments. Taxpayers have already had a violent verbal reaction to this fact. The idea that their own money serves the interests of a mass unrepresentative for the segment they are part of is an additional reason for the phenomenon of moral hazard to be brought into question.

Theories regarding moral hazard point out that the behavioral changes are not noticeable by the third person, which is, in fact, the key condition of the occurrence of the moral hazard phenomenon. Indeed, it is difficult to determine the extent to which the credit institutions "guilty" of producing the financial crisis will change their behavior in order to avoid future similar situations. Furthermore, it is impossible at this time and unlikely in the future to determine whether measures taken by various governments of the world are not exactly the germs of a future economic crisis.

II.2. The historical precedent

The concept of moral hazard can be easily illustrated by presenting the situation of the two giants of the U.S. mortgage market, Fannie Mae and Freddie Mac. If we consider the very context in which they came into being, evolved and later reached "the brink", we realize that the government intervention in creating situations of moral hazard is a plausible hypothesis.

In order to support this assumption, we will present the history of the two companies. Federal National Mortgage Association (FNMA) or Fannie Mae, as often called by the public, was

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[10] "Basme austriece de succes", Capital (Magazine), January 28, 2009.

established in 1938 as a government agency, as part of the New Deal[11]. The authorities at that time were trying to find a formula for reviving the national housing market, given that the mortgage market was basically frozen after the Great Depression. Fannie Mae would provide liquidity to the mortgage market, lending federal money to local banks, which, in return, would finance housing loans. Fannie Mae allowed, thus, local banks to charge low interest rates for mortgages, favoring the buyers of houses, in an attempt to make housing affordable. Among the positive effects of this interventionist measure of the U.S., we can count the development of the secondary mortgage market, where companies such as Fannie Mae can borrow money from foreign investors at low interest rates, because of the financial support of the government. By doing so, they can provide mortgages with fixed interest and small down payments. The profit was made from the difference between the rates paid by those who own houses and what foreign creditors ask as price for their capital lend.

For 30 years, Fannie Mae had a relative monopoly on the U.S. secondary mortgage market. In 1968, due to fiscal pressures arising from the war in Vietnam, the company is privatized, and thus removed from the national budget. At that time, Fannie Mae began operating as a GSE (Government Sponsored Enterprise), namely a company that is privately owned, generating profits for shareholders, while enjoying benefits such as tax exemption and government support (access to credit lines of U.S. Treasury). In order to prevent monopolization of the market, the second GSE was created in 1970, namely the Federal Home Loan Mortgage Corporation (FHLMC), later called Freddie Mac.

The combination private company - state support was beneficial, the GSEs marking a period of unprecedented financial growth. Thus, in 2008, the two entities owned or guaranteed almost half of all the $ 12 trillion of U.S. mortgage market and they controlled over 90% of the American secondary mortgage market. Their pooled assets are 45% higher than those of the largest U.S. bank. On the other hand, their debt represents 46% of 2008's U.S. national debt. It is this combination of rapid growth and indebtedness that caused concerns in the Congress, in the Department of Justice and in SEC (Security and Exchange Commission), which finally led to their (re)nationalization during the contemporary economic crisis.

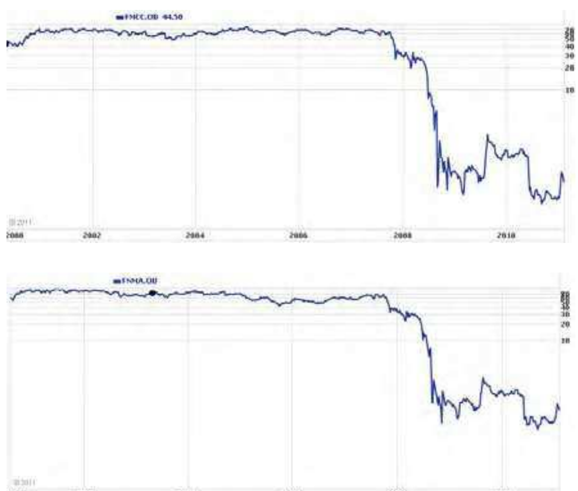
The situation was perceived somehow difficult. It should be noted that Fannie Mae and Freddie Mac are the only two Fortune Top 500 companies which are not required to inform the public about their financial difficulties. But if there had been a financial collapse of one of these companies, the U.S. taxpayers could have been held responsible for the debts of hundreds of billions of dollars. In this context, an investigation of the Justice Department and SEC about the accounting practices of Freddie Mac revealed accounting errors of 4.5 – 4.7 billion dollars and determined the dismissal of three top managers. In addition, Barclays Capital analysts have estimated that Freddie Mac's financial situation would have a negative value of at least 20 billion dollars if assets were valued at current market value. Fannie Mae's irregularities, on the other hand, are amounted to only three billion dollars. Both companies faced their stock dropping with almost 44% in just three days, due to the fact that government intervention became more and more an option, which meant the exclusion of other shareholders.

Hank Paulson, one of the recent secretaries of U.S. Treasury, sought a reversal of the situation, saying that there are significant amounts that can support Fannie Mae and Freddie Mac if necessary and that only by making funds available to them he can be sure they will not be used. The stratagem did not succeed, so Paulson had to prove the veracity of his statements by taking into charge the two agencies. The evolution of the two entities depended and will depend on the management of the U.S. government, but more important are the long-term effects of the decision to place the two institutions under the coordination of the Treasury.

[11] „Interventie comunista sau salvare din criza?", Piata Financiara, nr. 9 (2008).

By applying Bastiat's theory[12], one should take into account not only the visible effects, but especially those that hide behind the obvious. The immediate result of the notice regarding the entrance of the two under the state's tutelage was the revival of the stock exchanges, the investors considering this measure a support given to the mortgage market and, therefore, a guarantee that financial losses will not be deep. What is not seen is the fact that certain expectations were created, that the state will intervene to support the institutions in skidding, when needed, which automatically increases the risk for the situation to repeat itself in the future.

It is hard to predict the future impact of this point of view on investors. Capital might continue to inflow in the U.S. just because of these expectations that the state will intervene in case of a crisis. On the other hand, how many people would invest in a country that has just won a reputation of having dethroned an "increasingly concerned about the massive exposure to dollars"[13] China in terms of interventionism? Moreover, as stated by James Rogers, CEO of Rogers Holding, the one who has compared not so far ago U.S. to China, "this is welfare for the rich. This is socialism for the rich. It's bailing out the financiers, the banks, the Wall Streeters"[14]. Rogers believes that the move will have no effect on homeowners who are facing problems with reimbursements.



Charts 1,2: Stock evolutions of Fannie Mae(left) and Freddie Mac(right) between 2000-2010
Source: http://www nyse.com/

However, it is difficult to imagine how the situation would have developed if the government had not intervened. Some argue that Fannie Mae and Freddie Mac play such an important role in the American economy that the collapse of one of them would have serious effects not only on domestic but also on international financial markets. Even libertarians agree that the takeover is the best alternative, actually condemning government interference in the first place in the mortgage market. Overall, the total costs of supporting Freddie Mac and Fannie Mae transferred to the taxpayers are still unknown, given that the crisis prolonged from 2008 to today. Initially, the government could buy

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[12] "What is seen and what is not seen".

[13] Andrada Busuioc and Cristian Birau, „The Role of Reserve Currencies in the World Economy", *Challenges of the Knowledge Society eBook*, (2010):1379-1392 .

[14] "CEO: Fannie/Freddie Bailout Makes America 'More Communist than China", Business and Media Institute, 2008 .

up to 100 billion dollars in preferential shares in both companies, but further on the evolution depends entirely on the ability of the companies and hence the market to recover.

The adverse selection is the phenomenon that determined the discrimination in granting financial aid to some companies and not to others. For example, it is the information asymmetry – especially regarding the long term effects of such a decision – that determined the U.S. government not to intervene for saving Lehman Brothers, which resulted in panic on the market. The same phenomenon determined the discriminatory choice of the receiver and the amounts given by the American and the European financial authorities in the past years. To what extent the funds reached their best receivers is an unknown variable, one of the weaknesses of the theory of adverse selection and information asymmetry, in general, being the difficulty to quantify the effects of the results.

III. Information asymmetry and its role in the 2008 economic crisis

If we consider US subprime crisis the starting point of the global economic crisis, than we can name one of its triggering factors, namely the existence of asymmetric information on credit market, which, subsequently, can be found on capital markets.

III.1. Governement's intervention on the real estate market

The credit market is subject to the risk of adverse selection, meaning that credit institutions face serious difficulties in effectively selecting eligible customers for certain types of loans. Economists talk about the phenomenon of credit rationalization, which means that credit institutions set up a certain level of interest rate at which the amount of loans offered cover only a small part of the total demand for credit at that interest rate. Normally, an excess of demand would lead to a price increase, but on the credit market, this thing does not happen. Banks choose to keep interest rates steady and not to meet all debtors' demands. Traditional microeconomics explains this phenomenon by the special creditor-debtor relationship, by the standard risk situations or by different constraints that affect the variation of the interest rate, but it can also be explained through the concept of informational asymmetry.[15]

Specifically, one can assume that on the market there are two types of borrowers - those honest, accepting only those loan contracts that they can repay and they do repay them, and the bad payers, who at the time they take the loan are aware of their inability to repay, but hope to eventually get the resources needed to pay the debts. The bad payer debtors are even willing to pay a higher interest rate only to get the credit, and normally should have priority – and on some markets they do - in obtaining the good. However, on the banking market the situation is different in the sense that banks cannot distinguish between the bad and the good payer debtors before the reimbursement moment, so they choose to rationalize the credit, by setting an interest rate at a level that ensures a maximum return in terms of minimal risk, even as they face an excess demand.

Taking this situation as a state of fact in the early 2000s, we can say that the credit market was facing an excess of demand, unsatisfied both because some applicants were not eligible and because banks had only a certain amount of money available for lending.

Often, the fact that information asymmetry may cause distortion of the mechanisms of allocating on credit and capital markets determines state intervention, in order to improve the balance in these markets. The instruments used can be government guarantees and loans to certain sectors of the economy. Similar methods have been used by U.S., in order to correct the credit market imperfections in the early 2000s, already mentioned above. The main target of such interventions was the a boost of the housing market and economic growth, affected by the "dot-com" speculative bubble. Thus, it is not surprising that free market advocates consider U.S. federal authorities'

[15] George L. Serban-Oprescu, "Contribuții teoretice la dezvoltarea conceptului de informație în ştiința economică", (PhD diss., Academia de Studii Economice Bucuresti), pg. 156.

monetary policy as the main responsible for the subprime crisis. The reputable publication Wall Street Journal was writing in the mid 2000 on the effect of FED's "easy" money on house prices. Overall, it was admitted, in a tacit way, that the housing boom was unsustainable on the long term, but few were those who foresaw the consequences on credit market. Thus, an initiative meant to help the housing market, along with a strong social component, became at least a spring of the current crisis.

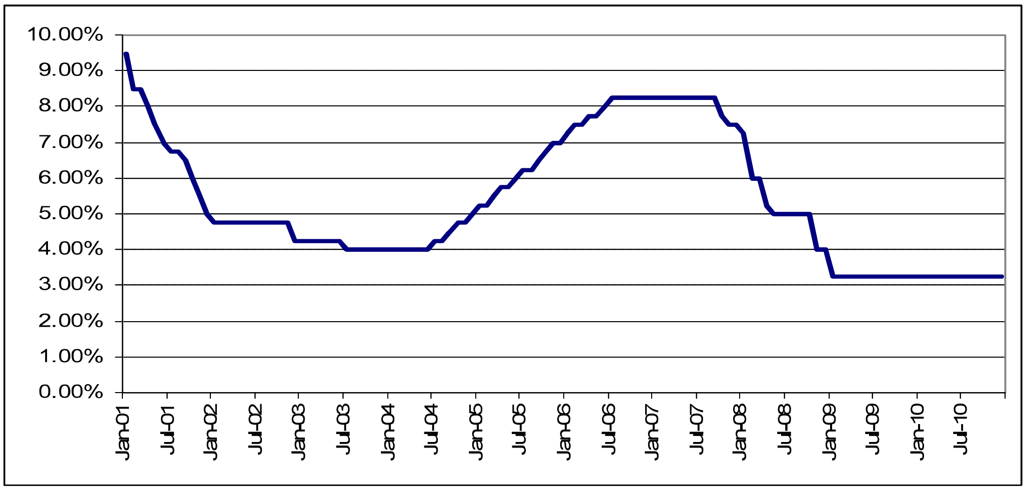

Chart 3: Evolution of FED's Prime Interest Rate between 2001-2010
Source: http://www federalreserve.gov/

The economists are blaming either the Bush administration, which implemented starting with 2004 a program designed to provide access to mortgage also to households with no equity[16], either to Alan Greenspan, the Fed governor during 1987-2006, who kept interest rates extremely low for a long time. Both theories can coexist, given that the fulfillment of Bush administration's "American dream" could not have been achieved without a relaxed monetary policy. Indeed, the conditions created by FED's low interest rates between 2000 and 2005 (a decrease in mortgage interest rate from 8% to 5.5%) enabled granting loans with a lower cost of capital. Commercial banks benefited of extra liquidity - as the U.S. economist Mark Skousen stated "banks needed to lend money to someone so they ended up lending also to those who did not afford a house"[17] – which allowed the phenomenon of selection effects to occur.

The banks also contributed to this situation, through their financial innovations for financing the mortgage market. If 20 years ago it would have been difficult to buy a house with less than 20% down payment, before the current crisis the banks and the brokers lowered the level or even removed it. Another factor that contributed to the crisis was the way the interest rates were set up. Alan Greenspan stated, in the early 2000s, that, given the fact that people keep the houses they buy for about seven years, it is illogical to pay a (higher) fixed rate for 30 years. This way, variable interest rates appeared on the U.S. market (they were called Adjustable Rate Mortgage - ARM). Flexible rates, however, are useful when the monetary policy rate has a downward trend, which was not the case in the U.S., as the level was already at around 1%.

[16] Bal Ana, "Opinii privind cauzele crizei financiare actuale", *The Romanian Economic Journal,* Nr .1(31)(2009):3-18.

[17] „Once upon a time in America", Piata Financiara, no. 3. (2008): 27 – 30.

The monetary authorities did also another mistake - although FED's responsibility is to ensure a stable monetary system, on one hand it allowed too lax lending policies, while on the other hand, it destabilized the interests' cycle, by determining a massive drop too fast, followed by a similarly fast increase. In just two years, the rates have increased by about two percentage points, determining reimbursement problems to the debtors who have not foreseen this change of trend and converting them into what we previously defined as "bad payer debtors". The major problem was that the loans could not be covered by mortgages, in many cases their value having fallen under the debtors' balance.

There are a few representative figures that truly place the beginning of the crisis in the first quarter of 2008. Wall Street Journal presented in March 2008 two key barometers of the U.S. housing market - the part of homeowners hold in their own buildings (calculated as the difference between the market value of homes and the mortgage size) and the number of mortgages in foreclosure. The first of them fell at that time to the minimum recorded after the Second World War, respectively 47%. As for the second indicator, according to data from Mortgage Bankers Association, more than 2% of the 46 million mortgage loans were in foreclosure process in the fourth quarter 2007, the highest figure since 1972, when this statistic started. In addition, the rate of nonperforming loans for the real estate sector had risen to nearly 6%, the highest value since 1985. One of five loans from the high risk category was overdue in the last quarter of 2007. So, the problems related to the contemporary economic crises are caused by past actions.

Another argument that supports the idea of informational asymmetry phenomenon being a contributor factor to the crisis is that of "predatory borrowing", Thus, even if the term predatory lending is more frequently used and part of the American public is talking about banks in these terms, experts say that the "prey" were actually the creditors, given that many mortgage brokers and lending institutions have either went bankrupt or lost money due to inefficient customers portfolio selection. This opinion is justified, given that statistics reveal some 70% of those who have borrowed in recent years have lied on loan applications. Moreover, even if the banks were to help the debtors to pay their installments on time, foreclosure being the last resort solution, most of the 90 days overdue debtors wanted foreclosure[18]. In most U.S. states, in case of mortgages, the house is also collateral, so if rates are not paid, the bank takes the property, but cannot pursue the debtor further on. When the debtors realized they were unable to repay their loans, they preferred to give up the mortgaged property, which, amid the events that took place, lost value reaching a level lower than the loan taken for its acquisition.

The adverse selection phenomenon manifested more strongly as the banks had an optimistic view on the situation - they assumed that the debtors who do not have a down payment are as stimulated as those who have invested their own money. However, the down payment is a safety net for banks, customers becoming a kind of partners. In its absence, the bank takes over most or even all the risk. This fact should be correlated with the diversification of banking products, which have a dual purpose: to banks, it meant an increase in turnover and access to potential customers less or not at all banked; while for prospective borrowers it was a way to buy a property they normally could not have afforded. Although apparently these two directions reconcile and are beneficial for both actors, in reality the diversification process, which aimed at finding alternatives for the customers not eligible for loans failed precisely because of the improper information between market realities and those expressed in economic theories.

Another aspect to consider is that, in order to determine an improvement in social welfare, government intervention should be based on information different from that of other market participants. If the government does not have additional information, which are unavailable to others, an intervention that only changes the structure of the market risks can cause negative effects that may equal or even exceed the negative effects that should initially be addressed through the economic

[18] „Once upon a time in America”, Revista Piața Financiară, no. 3 (2008): 27 – 30.

policy measures. The situation described above is precisely the one that occurred in the U.S. – given the lack of valuable information on the structure of the demand for housing loans, the government intervention has only made eligible a market segment that in a perfect market would not have had access to crediting. In terms of a definition, a perfect market is a market where no intervention and no information asymmetry exists. Moreover, we can say that the conditions created, facilitated the emergence of adverse selection, meaning that for the bank it become increasingly difficult to effectively discriminate between the eligible and the not eligible loan demanders. Thus, loans that would have been optimal for borrowers with a relatively low risk were given to risky customers, which ultimately were not able to cover their debt obligations.

III.2. The capital market – an informational asymmetrical market

The evolution of the global economy in the past decades is inextricably linked to the development of financial markets, among which the capital market has a special role. The investments play an important part in economic growth and development, but the relations between funders and investors can be often characterized by information asymmetry. This is due to the fact that investors are generally willing to present their current situation and future projects more favorably than they are in reality. Even when the representatives of the capital demand have all the information about the investors, it would be too expensive for them to process and evaluate them accordingly[19].

The reflection in reality of the above statements represent another process that allowed the outburst of the financial crisis, namely the securitization, which stands for "wrapping" of nonperforming housing loans and rating them maximum grade. The information asymmetry manifested this time through the rating agencies, which did not have complete information about the instruments they rated. Further more their scoring activity was shielded by the conflict of interests resulted from the fact that they are paid by those who perform the securitization of the financial instruments, but only if those instruments are sold. The fact that the global market is an oligopoly, 90% controlled of three companies (Fitch, Moody's and Standard & Poor's) and that both in the U.S. but also globally Securities and Exchange Commission (SEC) has exceptional attributes, such as to decide who is assumed to perform the rating, adds further suspicions. For ten years SEC has constantly blocked the U.S. rating market from new competitors and through its influence minimized the importance of other such entities in the world. This has only aggravated the situation. Arguments later given to support their erroneous ratings, such as the one of Lehman Brothers ("the rating agencies act on the rating if the market sentiment becomes reality, trying to avoid the establishment of panic"[20]), only bring forward to "the public's attention the issue of rating agencies' independence in respect to the entities they assess"[21].

Thus, the rating agencies had a strong incentive to provide a high rating, so many banks and investment funds bought these bonds. International contagion was completed when the small investors realized that, instead of the reliable bonds that have been advertised to them, they have an important illiquid part of portfolio, consolidated in junk bonds. The lack of information to enable an informed investment - in this case the existing erroneous information derived from unrealistic ratings - has determined a damaging situation for many investors all over the world. Although the capital market can be characterized by the formula "you invest, therefore you accept the risk of losing", information asymmetry makes the quantification process of risk extremely difficult, or even

[19] Basarab Gogoneață, *Informația asimetrică în economie*, (Bucuresti: ASE 2003), p. 120.

[20] Andrada Busuioc and Cristian Radu Birău, „Influențele geopoliticului asupra evaluării riscului de țară", *Studia Universitas Științe Economice*, no. 20 (May 2010): 611.

[21] Andrada Busuioc and Cristian Radu Birău, „Influențele geopoliticului asupra evaluării riscului de țară", *Studia Universitas Științe Economice*,no. 20 (May 2010): 612.

impossible to be determined. Such was the case of the subprime economic crises, which converted to a financial crisis and afterwards to a global economic crisis.

Another problem is the mismatch between the goals of shareholders and those of the managers, which indicates the existence of the adverse selection phenomenon in the management of joint stock companies. The lack of information determines the shareholders, as owners, to delegate the control to managers, and the same lack of information makes it possible for managers to pursue their own interests further down the hierarchy. Thus, the managers were stimulated to pursue short-term profit, which brought them huge bonuses, approved by the shareholders who rewarded only the visible results, without access to information on the entire mechanisms of these results.

Conclusions

This paper addresses the problem of information asymmetry and its influence on the contemporary economic crisis. Through it, it is revealed that this phenomenon had its part to play in fuelling one of the hardest economic periods after the Great Depression of the '30s. The article puts in light the fact that information asymmetry is one of the most used concepts for explaining the existence of the current crisis, by analyzing facts and figures related to U.S. economy.

The information asymmetry has strong links to the contemporary economic crises, based upon the fact that the subprime crisis, which has actually triggered the World's recession, was constructed on components deferred to this area. Thus, it is clear the fact that decisions making factors have neglected the basic principles of asymmetric information conducting to the existent situation.

It was revealed that a wide range of actors involved in economics are to be blamed for creating the premises under which asymmetric information was formed. On one hand, the US government, as entity responsible for organizing a certain economic environment, has involuntary supported the perverted effects on the real estate market, through its long term decisions. On the other hand, creditor, intermediaries and debtors have each their guilt part in consolidating this phenomenon, regardless if they relate to lending money too easy, having a conflict over scoring or following just their inducted consumerist behavior.

The main issue that comes out of the study is that governments have had a major part to play in this entire situation. Further more, their actions influenced also third parties which acted under their authority. Adverse selection manifested itself through the fact that countries, investors and intermediaries acted previously and through the contemporary crises with information of different quality and quantity. Moral hazard became synonymous to short term focusing, while neglecting risks. Nowadays, this aspect has proven to be sustained and even fueled by the government bail outs of the contemporary economic crisis.

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