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STABILITY POLICY DURING ECONOMIC DOWNTURN: INSTITUTIONAL AND INTERVENTIONALISTIC ASPECTS

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Abstract. *The issue of stable policy became extremely relevant during the recession. Stable policy encompasses recovery of the lost equilibrium, prevention of the undesirable situation and assurance of sustainable economic development. Two competitive decisions of stable policy – intervention and institutional – can be accentuated. Intervention strategy means supply stimulation and balance recovery through fiscal and monetary policy. Institutional stable policy stresses the prevention of unwanted situations through creating a resilient institutional economic structure and freeing the market self-regulation mechanism. The article compares both strategies, analyzes their consequences, influence on the development and depth of the crisis, and possibilities of the national adaptation mechanism.*

Key words: *institutional and programme flexibility, stability policy, national adjustment mechanism, flexibility of working relations, economic activity fluctuations*

Introduction

The USA financial crisis in 2007 spread rapidly and reached the real economic sector. Most countries encountered a decreasing activity of economic institutions, an increasing number of bankrupts and unemployment. The governments stepped in to aid the economy in regaining equilibrium. Representatives of different economic fields agree to the need of stabilization policy[1]; however, the efficiency of the tools used for the stimulation of supply during the economic downturn is still under debate. The increasing risk and interest in the financial sector, the negative foreign trade balance, effects of the Ricardian equivalence (reserved behaviour of consumers due to expectations of future tax increase) decrease the effectiveness of conjunction programmes. In this situation, scientists advise to refer to the causes of the crisis and to search for the possibilities of preventing the

[1] Stabilization policy is commonly associated with the Keynesian supply stimulation and global regulation policies, which were implemented in the seventies and eighties (Wagner, 2008).

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unwanted situations; conjunction programmes alone are seen as insufficient[2]. This implies coordination of economic stabilization decisions with the crisis prevention tools, in other words, the stability policy[3].

The aim of the article is to reveal the interplay between economic activity fluctuations' prevention and institutional economic structure.

The research object is the stability policy during an economic downturn.

The objectives of the article are: to introduce the concepts of institutions; to discuss the importance of institutional and programme flexibility during an economic downturn; to present the alternatives to stability policy and possibilities of national adaptation mechanism.

Theoretical background. The linkage between economic fluctuations of entities and institutions is analyzed. Separate aspects of this linkage were analyzed by the representatives of the early economic thought schools (A. Smith, J.St. Mill, K. Marx, M. Weber). Exclusive attention to the institutional development factor was shown by Austrian economists J. Schumpeter, L. von Mieses, F. von Hayek in the beginning of the 20th century. A new interest in institutional development factors is seen in the theory of property rights, transaction cost economics, agency theory, comparative analysis of economic systems, etc.

The role of the institutional society structure in the globalization conditions is analyzed by scientists of the Centre for European Economic Research, theoreticians of the optimal currency area and members of the EU academic society. The research carried out by the scientists undermines the importance of the country's institutional structure in overcoming economic fluctuations.

Lithuanian scientists analyze the influence of institutional environment on the economic development (Jankauskas, Seputiene, 2009), the importance of the institutional factor while reacting to the changes triggered by globalization (Kropas, 2007, Karpavicius, 2008). The institutional barriers of national social wellbeing have been analyzed in the academic literature (Lazutka, 2007, Kuodis, 2008, Gylys, 2008).

The article is composed of three parts. Theoretical discussions regarding the institutional aspect, institutional changes, institutional and programme flexibility as the

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[2] Conjunction programmes were valued skeptically not only by radical government critics (as Hülsmann, 2008), but also by other economists (as Blankart, 2008). Around 200 USA economists (among them Nobel price winners Buchanan, Preston and Smith, Becker and Murphy) in the beginning of 2009 expressed a doubt that the budget increases encountered during the economic hardship will be ever reduced in the future. The economic historian Ferguson (2009) cannot imagine that politicians would be able to develop an efficient conjunction programme.

[3] The aim of the stability policy, differently from stabilization policy, is not only to recover the lost equilibrium, but also to prevent the undesirable situation and ensure the sustainability of economic development (Wagner, 2008; Molitor, 2006). This conception is reflected by state stabilization laws.

main conditions of adaptation are analyzed in the fist part of the article. The second part focuses on the discussion of stabilization policy alternatives, and the third part deals with the adaptation possibilities of the national adaptation mechanism.

Institutional and programme flexibility: theory and practice

Institutions are interpersonal, formal or informal rules and norms, which control the behaviour of economic entities (Wintermann, 2005). In the broad sense, institutions are perceived as "rules of the game" (Imergut, 1992). Nevertheless, scientific literature does not provide a uniform opinion on what the institutions are: rules (North 1990); rules and organizations (Polanyi, 1957; Dietl, 1993); legal procedure, organizational and social mechanisms (Balcerowicz, 1995).

Disregarding different opinions on the perception of institutions, all scientists agree that institutions form the foundation for the expectations of economic entities (Wintermann, 2005). In the case of the distortion in the balance, in addition to behaviour control, they perform an insecurity lessening function (Heiko, 1977). A decrease in uncertainty stabilizes the expectations of society. Institutions are assumptions of a successful behaviour of economic entities in a complex and constantly changing environment (Jochem, 2009). They influence the expedience of an economic entity's problem solving activities.

The institutional system of a country is composed of the totality of institutions (Balcerowicz, 1995). Many subsystems can be distinguished, and one of them is the economic subsystem. The economic subsystem is based on rules which regulate the economic activities of the entities. They serve as guidelines for the implementation of macroeconomic stabilization polity (Balcerowicz, 1995). The institutions that ensure stability are also pressured by changes. The causes of institutional changes were explained by the Austrian economist J. Schumpeter (1934); he related the survival of capitalism with innovations. In the conditions of global economy, innovations spread only if there are institutional premises. Institutional changes are determined by international economic fluctuations which lead to economic hardships and crises. Therefore, the structure of institutional society should be continuously improved (Kropas, 2007) by creating rules enabling flexible reactions to unexpected external shocks. Reforms are necessary due to global economic shocks and local demographic changes (Kaufmann et al., 2005), cultural factors and new values, which influence the stile of life, wellbeing, social justice expectations, etc. (Jochem, 2009). Changes in rules signal institutional flexibility (Wintermann, 2005). Scientific literature explicitly discusses the paradox of the institutions that coordinate the behaviour of economic entities: effective trade is

possible due to institutional stability; however, the need for economic entity coordination changes; therefore, institutions need flexibility to reflect the dynamics of society. When the contradiction between the need of stability and change is great, institutions are changed (Pascha et al., 2005). The need for economic entity coordination is not static but rather dynamic (Lin, 1989). Modern society is a product of institutions and their creator (Lepsius, 2009). Institutions stabilize the behaviour while changing (Lessenich, 2003). On the one hand, institutions guaranty the stability of society, on the other they are an economic development factor, an element of dynamics (Lessenich, 2003). An institution simultaneously is a product of society and a process (Schulein, 1987).

The process of institutional changes is gaining ground, however slowly (Scharpf Schmidt, 2000). Changes are related to risk, and economic policy makers try to avoid it. Windows of opportunity, which facilitate deviations from strategic development, are created only in exceptional cases (economic crises) when economic uncertainty increases (Muno, 2005). Nevertheless, certain rules are very resistant to changes. Often scientists (Jochem, 2009) tender the social insurance principle, the rule that serves as an obstacle in reforming the social security system, especially during economic hardships.

The institutional structure changes during economic hardship depend on the social ability in a short time to retreat from the traditional programme and create conditions for the government to react to the changed situation. The deviation from the strategic reforms is called programme flexibility (Wintermann, 2005). According to D.C. North (1990), organizations are the institutional change agents, given that they create programmes. Programme flexibility determines the government's ability to react to economic hardship and the effectiveness of its separate factors (Petschow et al., 1998).

Programme flexibility of Lithuania's organizations is reflected by the national agreement, a document signed by the Lithuanian government and social partners (professional unions, organizations of disabled, business and employers and retirees) in 2009.

National agreement raises the aim of overcoming Lithuania's recession and restoring the economy. This agreement anticipates specific measures in public finance, business competitiveness, investment activities and other areas. These measures have raised discussions in society. This has encouraged scientists to return to fundamental questions, for instance: what is Lithuania's prosperity module; on which economic theory is Lithuanian market economy based; which economic regulation measures, neoclassical or neo-Keynesian, are more appropriate during economic hardships; what are the national adaptation mechanism possibilities in Lithuania.

Strategies of stable policy

The stabilization policy encapsulates the tools for rebalancing the economy, prevention of unwanted situations and economic development sustainability insurance (Wagner, 2008; Molitor, 2006). The strategy of intervention or institutional stability policy is selected based on the tools with a higher priority (Schüller, 2009). Various examples of intervention strategies are presented extensively in the scientific literature (Schüller, 2002). Their aim is to regulate supply through monetary and fiscal policies. Conjuncture programmes stimulate supply, production and employment. The government's participation in goods, labour, real-estate, capital and foreign exchange markets, subsidies to particular areas of economy rebalance and speed up the economic recovery. Utility criteria are determined by government's intervention if the market itself is unable to ensure effective resource allocation when it is essential to eliminate coordination mistakes (Tomann, 1997). This market performance aspect interested Keynes. He theoretically justified partial employment of resources as a problem of the market forces and the need for state's intervention. The idea of "economic policy" belongs to Keynes (Wagner, 2008). The followers of J.M. Keynes build market development models which provide us with an ability to analyze periodical economic activity fluctuations, to explain the causes for the crisis and their prevention possibilities. Scientists have proven that conjunction fluctuations are impossible to eliminate; therefore, the task of the stabilization policy is to keep the fluctuations in a certain range, because the market system itself is unstable and reacts to the smallest impulses (Suntum, 2005).

Advantages and disadvantages of intervention policy are explicitly presented in the academic literature. The researches show that this stabilization policy impedes the economic self-regulation function of the market through the price mechanism (Hayek, 1975), weakens market power (Hamm, 2003, 2004), disturbs microeconomic stabilization (Schüller, 2009), and slows down the long-term economic development (Hülsmann, 2008). Businesses are deprived of the signal needed to react to the changing situation; economic entities base their expectations on the governmental policies. This situation is understood as market limitations; therefore, the state's influence grows, and intervention policy becomes an important element for governments.

Monetary and fiscal policies are used to improve conjunction, decrease unemployment and to achieve social political aims (Schüller, 2009). For instance, low interest rates or tax incentives are used to encourage the real estate market. In order to support supply, savings are no longer seen as the assurance of existence and wealth, but rather as an instrument of fostering conjunction. Old methods of saving (cash registers (from Lithuanian: *taupymo kasos)* for building financing) are replaced by mortgage service providers. Expansionary

monetary policy determines massive bankruptcies, which are followed by a decline of real estate prices. Bankruptcies correct faulty investment decisions made at the time of low the interest rates (Woods, 2009; Hülsmann, 2008; Higgs, 2009).

The idea that economic activity fluctuations are created by regulations was postulated by new classicists during the second half of the eighties. The concept of supply-side economics[4] is based on this idea. Governments' intervention can lead to economic crisis which has a tendency to spread globally due to globalization. Nevertheless, not all countries are equally affected by international economic activity fluctuations. This idea is underlined by the scientists (Hamm, 2004; Schüller, 2009) that represent the strategy of institutional stability policy. The expansion, depth and duration of the economic crisis depend on institutional factors, such as the stimulation system, resource allocation peculiarities, the flexibility of economic structures, etc. (Schüller, 2009). Based on the premise that social welfare is determined by the institutional economic structure, scientists undermine the importance of the economic crisis prevention policy and advise creating an economic structure resilient to internationally spreading fluctuations. The implementation of this objective is associated with the liberation of the self-regulation mechanism, utilization of its possibilities, and creation of opportunities for economic entities to adapt to the changed realization conditions, prices, wages, interest rates and foreign exchanges. Liberating the self-regulation mechanism means pursuing the reforms that increase the power of the market. The rigidity of taxes, wages and social deductions reduces the ability of economic entities to adapt to unfavorable conditions during economic downturns. The crisis deepens and extends for a longer period of time. Parties and various unions strive to aid separate businesses, economic sectors, branches or regions. They appeal to the importance of saving jobs, therefore, market functions are transferred to the government. Microeconomic stabilizations are replaced by government's intervention, which is politically easy to implement (Schüller, 2009).

The advocates of institutional strategy (Hamm, 2004; Schüller, 2009) deny the importance of the government's economic policy. The risk of misbalance always remains. Nevertheless, this risk could be adjusted by using conjunction policy, monetary and fiscal policy tools. However, these tools must be consistent, determined in advance. The premise of a sustainable crisis prevention policy is a consistent rule policy[5]. Stable

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[4] The concept of Supply Side economics was postulated in the eighties and nineties. The main theses of supply side economics are tax reduction for producers; deregulation, flexibility of working relations, regulation of the quantity of money according to the recommendations of monetarists (Laffer, 1981).

[5] Stable rules are determined in advance (ex ante), whereas discrete policy tools are applied only in a certain situation (ex poste) (Tomann, 1997).

rules (for instance, the stable quantity of money rule[6]) mean that economic entities have time to analyze the deviation from the balance and react on their own before the intended intervention of the government. This self-stabilization of the situation is deflationary market self-regulation (Woods, 2009).

The correct policy of rules determines the behavioral changes of the economic entities in the conditions of instability. According to John Taylor (2009), if the American Central Bank would have followed the Taylor rule[7], the US could have avoided the financial crisis. The Austrian economist Thomas Woods (2009, p. 8) describes the input of the American Central Bank as "The *Fed's* policy of intervening in the economy to push interest rates lower than the market would have set them was the single greatest contributor to the crisis that continues to unfold before us. Making cheap credit available for the asking does encourage excessive leverage, speculation, and indebtedness. Manipulating interest rates and thereby misleading investors about real economic conditions does in fact misdirect capital into unsustainable lines of production…" Keynes' follower Paul Krugman (2008, p. 152) also criticizes the monetary policy of Alan Greenspan: "Cynics said that *Greenspan* had succeeded only by replacing the stock bubble with a housing bubble – and they were right."

According to the supporters of the institutional view, economic policy based on the stable rules has many advantages: the risk of popular decisions and the influence of political conjuncture on production decreases, the trust of economic entities in governmental institutions increases, and the citizens become more optimistic. Lithuanian scientists note that the decision to use a fixed exchange rate was one of the wisest economic policy decisions in Lithuanian history (Kuodis, 2008, p. 99). Nevertheless, the stable rule policy deprives a country of the ability to influence conjunction fluctuations through monetary intervention. Some scientists (Wagner, 2008) express doubts as to whether a stable rule policy is possible in practice. The self-adaptation process is not smooth due to formation of rational short-term expectations and existence of long-term contracts between economic entities. Research (Van den Noord 2002) shows that only one third of economic activity fluctuations in the euro-zone countries are self-regulated. The effect of self-regulation depends on the type of the shock that creates economic fluctuations

[6] M. Friedman (1968) suggested to regulate the growth of the quantity of money in accordance to the annual growth of the national domestic product. In order to avoid economic activity fluctuations of economic entities and a decrease in the security of the private sector which is challenged by economic policy tools, the quantity of money should be determined according to the stabile rule. The stabile rule of the quantity of money acts as a self-stabilizing mechanism: high growth rates provoke a lack of money, and low growth rates provoke a surplus of money.

[7] The interest rate of the Central Bank is determined according to the inflation and economic development rates.

(whether it is internal or external, supply or demand, consumption or investment). It can strengthen due to the weakening internal demand, but not export or investment activities (Vogel, 2007). Self-stabilizing tools are effective during the demand shock; however, if supply is rattled, their effect can be destabilizing (Buti et al., 2003).

The scientific literature of the past decade notes that the structural reforms that ensure flexibility of nominal measures and greater economic competitiveness are unable to deny the value of fiscal policy as a stabilizing tool (Heine, Herr, 2003; Vogel, 2007). According to L. Vogel (2007), structural reforms and fiscal policy are not substitutes but rather compliment each other. Both of them are important for overcoming demand and supply shocks. Reforms increase the possibilities of production; nevertheless, these possibilities not always ensure a rapid economic development and the desired resource utilization level (Hein, Truger, 2002). Most recent discussions show that in uncertainty conditions both stable rule and discrete tool strategies are adequate (Tomann, 1997; Wagner, 2008). The decreasing economic activity in 2007 pushed countries towards discrete policy tools: to decrease taxes and payments to the state and increase budget expenditures. Funds committed to restore the conjunction amounted to about three and more percent of GDP (Table 1).

TABLE 1. **Fiscal policy tools in 2008–2010 (percentage of GDP for 2008)**

	Reduction of taxes and transfers to the government	Increases in governments expenditures	Stabilization of the financial sector
Euro-zone countries	0.7	0.7	12.5
Germany	1.6	1.4	23.3
France	0.2	0.5	3.6
Great Britain	1.5	0.0	2.5
USA	3.2	2.4	4.2
Japan	0.5	1.5	20.7

Source: OECD; Bookings Institute; Eurostat; IMK.

The stabilizing effect of the discrete actions depends on a particular tool applied. A decrease in taxes or an increase in transfers require less time, than the implementation of public investment projects. Empirical research has showed that an increase in expenses in a short term provides rather for a greater stimulation of supply than for decreasing taxes[8]. The assessment financial policy tools calls for a closer look on its effect on supply through conjunction programmes and automatic stabilizers (Wede, 2009). Their

[8] Individual fiscal policy multiplier effects in various countries are overviewed in OECD (2009), Economic Outlook (Interim Report Marz 2009), Paris.

role in different countries varies. It is determined by the size of the public sector, the scope of social deductions, and the level of progressing taxation (institutional economic structure). The budget burden increases during economic recession in countries with stronger automatic stabilizers. The intended scope of the conjunction programmes was smaller in the countries ((France, Belgium, Holland) where automatic stabilizers played a greater role. For instance, France intended to spend only 0.7% of the GDP in 2008 on supply stimulation (Table 1). The financial deficit of the majority of countries grew due to the expenses on the automatic stabilizers, objective conjunction restoration programmes and financial aid (Table 2).

TABLE 2. **Financial balance of the general government (as a percentage of GDP)**

	2007	2009	2010
Euro-zone countries	-0.6	-6.1	-6.7
Germany	0.2	-3.2	-5.3
France	-2.7	-8.2	-8.6
Great Britain	-2.7	-12.6	-13.3
USA	-2.8	-11.2	-10.7
Japan	-2.5	-7.4	-8.2
Holland	0.2	-4.6	-5.9
Belgium	-1.2	-5.7	-5.6

Source: OECD; Bookings Institute; Eurostat; IMK.

The association of budget's revenues and expenditures with economic fluctuations, in other words, the application of flexible policy rules, strengthens market's self-regulation processes (Calmfors, Corsetti, 2003; Vogel, 2007). The aim of the government to balance the budget during an economic downturn, in other words, to reduce expenditures and increase taxes, agitates the practice of economic entities. The recession deepens, if the government is unable to initiate intensive actions due to the lack of savings or limited borrowing possibilities.

Lithuanian scientists (Kropas, 2007) stress the pro-cyclicality of the country's budget policy and long-term shortage for the state. During the economic boom, the Lithuanian government pursued the intervention policy instead of increasing savings and creating reserves needed during economic downturns. The political stability decreased and saving during the economic downturn deepened the recession.

Institutional adaptation possibilities of the national mechanism

How to overcome the international economic fluctuations, when long-term fiscal policy rules do not leave space for discrete fiscal policy measures? As the academic literature

underlines, the adaptation burden in this case is levied on the mobility of production factors, prices and wages.

The mobility of production factors (mainly work force) serves as a substitute for the inflexible exchange rate in absorbing international economic fluctuations – shocks (Engelkamp, Sell, 2005). The greater the mobility of production factors, the lower the costs of shocks (e.g., unemployment) (Gorgens et al., 2004). Although the movement restrictions of resources have significantly decreased in the last decades, nevertheless, certain work force segmentation persists, and a plethora of countries still restrict work force immigration. The differences in languages and cultures influence the international work force mobility. Scientists (Belke, 2002; Engelkamp, Sell, 2005) indicate low work force mobility as a limitation factor in adapting to international shocks.

Insufficient work force mobility causes adaptation through changes in wages. The scientific literature (Breuss et al., 2000; Wagner, 2008) underlines the increasing role of wage politics in regulating the economic activity of entities.[9] Only with the use of wage politics we can overcome asymmetric shocks created by real changes in wages. Derangement in supply deprives monetary and fiscal policy from stabilization power, because the application of economic policy tools creates a conflict between price stability and economic development (Enderlein, 2004). Hagemann, Horn (2008) criticize the responsibility of monetary policy for price stability and wage policy liability for employment. Wage policy, together with the monetary policy of the European Central Bank (ECB), is responsible for inflation (Priewe, 2008). Gorgens et al. (2004) show that the role of wage policy is not limited to the regulation of entities. The composition of wages and the flexibility of work relations determine the structural resistance of countries, the attractiveness of location and its competitive advantage. An important object of academic discussions at the EU level is the international compatibility of wage formation in member countries. Enderlein, (2004), Gorgens et al. (2004) underline that different wage systems could persist in theEuropean Union while thecurrency exchange mechanism was used to reduce economic fluctuations. The structured monetary union, distinctly from the wage policies, conditions different levels of inflation, average labour costs, real interest rates and trade balance differences. This influences the adaptation process through decreasing the efficiency of monetary policy tools. After the supply shock (prices increase for energy resources and inventory), inflation increases in some countries, while in others it remains stable. The existence of different wage systems,

[9] Wage policy in a wide sense encompasses wage policy of social partners, policy which regulates working hours and the influence of social partners on developing the institutional structure of the labour market (firing rules, work contracts, unemployment benefits, etc.) (Gorgens et al., 2004).

especially when the mobility of labour is low, impedes the economic development and an increase in employment. Regional differences emerge and social gaps increase. Breuss et al. (2000), Priewe (2008) propose to make formation of the wage mechanism a common task rather than the discretion of separate countries; in addition, they suggest coordinating national wage systems according to the formula: the long-term growth of labour productivity plus an objective inflation norm set by the ECB. The conception of wage policy oriented towards labour productivity is one of the greatest social discoveries (Eekhoff, 2002). The main advantage of this wage policy is its neutrality towards costs. The increase in wages depending on labour productivity growth rates does not the change the overall price level. The discrepancy between long-term wages and labour productivity increases inflation or decreases employment. The implementation of wage policy oriented towards labour productivity increases the international competitiveness of the country, ensures the growth of consumer demand and productivity (Hagemann, Horn, 2008).

The strive towards price and income stability in the euro zone, according to Breuss et al. (2000), is essential for the international coordination of wage policy. Presently, the EU does not impose any limitations on national wage politics. Labour productivity and wage structure vary among countries, not only due to the activeness level of professional unions, but also due to a different perception of unemployment (Bulhaupt, 2001). Social partners in a particular country play an important role in resolving unemployment issues. The dialogue of social partners in one of the countries influences the macroeconomic measures and financial markets in neighboring countries (Breuss et al., 2000). The analysis of social partners' behaviour provides investors with information regarding the expected level of prices, real interest, etc. The reaction of participants in the financial markets influences the entire European goods market and creates economic fluctuations. The uniformity of wage policy would lead to the harmonization of conjunction cycles (Breuss et al., 2000).

The implementation of the wage policy oriented towards labour productivity does not signify an identical labour structure in all sectors (regions or ES countries) or that the predetermined formula cannot be modified. Wage structure can vary due to differences in labour productivity, structural changes in the economy or the situation in the labor market (Eekhoff, 2002). The flexibility of work relations is demanded by the increasing international integration of the markets. Inflexible structures derange the adaptation to the changing conditions. The effectiveness of wage policy depends on the flexibility of work relations, which in turn relies on minimum wage regulations, pricing policies in a company, wage policy (effective wages), the practice of professional unions, etc.

Scientific literature broadly covers wage regulation questions. National minimum wage regulation decreases the flexibility of work relations and thus deprives of the ability to change the salary when the demand decreases. Therefore, the adaptation requires firing, i. e. unemployment increases and the recession is prolonged. The unemployment payments discourage job searching or undertaking low paid jobs; paid transfers decrease the wage flexibility (Gorgens et al., 2004). The inflexible labour market creates favourable conditions for an asymmetric effect of the restrictive (or expansionary) monetary policy (Calmfors, 1998).

The easier adaptation to international economic fluctuations requires a free market mechanism, abolishment of redundant market regulations and barriers (Buscher, 2008). Work relations aught to be reformed in countries with a restrained monetary policy (euro-zone or currency board agreement countries) in order to overcome economic fluctuations (Calmfors, 1998).

The institutional environment of the Lithuanian labour market is valued as rather liberal because of relatively flexible wages (professional unions are inactive or powerless, collective wage stipulation is not prevalent) and low unemployment payments (Vetlov, Virbickas, 2006). The research (Virbickas, 2009) shows that the wage practice applied in Lithuania (a rather strong wage dependence on a company's performance) softens the economic fluctuations caused by supply. Nevertheless, further improvement in wage regulation flexibility, implementation of effective wage systems, creation of new jobs, liberalization of firing initiated by the employer, flexible perception of working hours, etc. are incorporated into the economic development plan of Lithuania (ESP, 2009). The flexibility of work relations remains the central condition for the efficiency of the national adaptation mechanism.

Blanchard and Katz (1992), who analyze the economic peculiarities of single currency countries, advise not to overestimate the possibilities of the labour market as the adaptation mechanism. This concerns the mobility of labour force and the flexibility of real wages. Economists (Burda, 1999) draw attention to a decrease of wage flexibility after admission to the euro zone. This could be explained by a decrease in prices, inflationary expectations and an increase in supply elasticity to prices (Apolte, Vollmer, 2002). The flexibility of nominal wages would mean shorter labour contracts, enabling to change the nominal wage more often. Calmfors (2000), Hartwig and Thieme (1999) doubt that nominal wages can be significantly decreased during economic downturns (or low inflation). Such a behaviour would indentify a decrease in motivation and productivity. Strong shocks (war, natural disasters) are needed for flexible social norms to appear.

Therefore, the labour market has quite limited possibilities as a tool for the national adaptation mechanism in overcoming internationally spreading economic fluctuations. Decentralized determination of the wage structure, existence of different working hours and motivation systems, the decreasing international abilities of professional unions and employers to inter-coordinate actions complicate the implementation of flexible strategies in the European labor market.

Conclusions

1. The institutional structure of the economy influences the adaptation process. It consists of interpersonal, formal and informal rules and norms which control the behaviour of economic entities and form the social incentive system. Institutional flexibility decreases uncertainty, increases the efficiency of economic policy during economic hardships. Institutional flexibility implies a flexible (discretionary) implementation of regulation policy. The prioritization of stable or flexible policies should not be made during the times o economic uncertainty. Classical benefit criteria underline both strategies, stable rules and discretionary tools (governmental intervention during recessions) as compatible. Changes in institutions are related to organizations which pursue their aims indentified in their programmes. The possible deviations of the programme from traditional decisions in certain situations influence the adaptation process. The national agreement signed by the Lithuania government and social partners (professional unions, organizations of disabled, business and employers and retirees reflects institutional and programme flexibility and enables a timely reaction to problems and their effective solution.
2. The application of stabilization policy tools during economic hardships aught to be based on a thorough analysis of the causes of crisis, oriented towards prevention and strengthening the economic resistance. The conditions for the prevention policy are a free self-regulation mechanism, creation of possibilities for economic entities to adapt to prices, formation of the wage mechanism. These means of adaptation cannot be ignored or replaced by intervention tools. The possibilities of stable policy are decreased by the scarcity of resources allocated for conjunction programmes. During economic booms, it is advisable for the governments to suspend the intervention policy and to stimulate saving in order to create a reserve for the future. Saving during recessions amplifies the decline. An important crisis prevention condition is to abandon the pro-cyclical monetary and credit policy.
3. The EU members following long-term fiscal policy rules are unable to employ discrete fiscal policy rules. In this case, the primary burden of adaptation is levied on the mobility of production factors, prices and wages. The reform of labour force is

one of the few alternatives toincreasing economic resilience against internationally spreading economic fluctuations. The flexibility of working relations, on the one hand, increases the effectiveness of the national adaptation mechanism. However, it induces motivation and labour productivity problems, sharpens social dilemmas.

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