Fiscal Policy and its role in ensuring economic stability

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15 February 2010

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Key words: *fiscal policy,fiscality, economic stability*

JEL Classification : G32, G38, H50

ABSTRACT

The State, irrespective of its institutional nature and contents throughout history, has been the most important answer or, better said, the best-structured solution of society members to the issues of their world's complexity.

Processes such as globalization and integration, individuals' increasing reliance upon technology, limited vital resources in order to ensure normal life, social polarization growth, poverty augmentation, migrating flows, occurrence of diseases that can rapidly spread at world level – all the above increase the complexity of our world and make the State's economic involvement compulsory. In this respect, an important role is held by the fiscal system, originally created to meet strictly financial goals of the State but subsequently enriched by various economic and social objectives due to the development of human society.

Fiscality can be viewed as a prerequisite to compensate gaps and for a genuine European policy of economic growth.

The impact of fiscality upon society members in every economy is significant, with tax payers' acceptance or refusal having a major effect upon the State's intervention by typical means in the entire activity of a society.

The paper suggests a analysis of fiscality in Romania.

Romania suffers from the lack of "self-image" and the factors generating it are also to be found in the present paper.

1. Introduction

The building and the expanding of the European Union from 6 to 27 member states was a process developed in 50 years. In 1957 the European Community was founded in only six countries, but the next stages reached 27 states with Romania and Bulgaria that joined at the 1st of January 2007.The assessment of the role and place of Romania in the context of the regional and between the regions cooperation must leave from the new dimensions of the globalise process of regional integration, from the fast changes on the scale of the geo-economic positions and from the world strategies taking into account that in the current wave of globalising, the performing economies prove to adapt fast to the world economy.

The fiscal systems represent a key factor to influence the efficiency of the economy. Many researches were done in the fiscal area both in our country and at an international level.

The focus on the impact of the fiscal factor over the budget and the economic development in the integration context and the issue of some scientific elements in this area was not achieved priviously.

In the conditions of a new stage – Romania a member state of the European Union, the integration of the Romanian fiscal system in the European fiscal system becomes a necessity. After the integration in the European Union, all the world faces a new fiscal system : the administration fiscal offices must take into account the European juridical prudence the courts must understand and apply the communitarian rights, the authorities must respect the fiscal European law. No at last, the business people must integrate into a fiscal system where they have to give up childish methods related to the off-shores and must understand the civic spirit and participate to the financial effort of the community. For the EU as a group of states and as a sample of the economic globalising, the fiscal system has a strong influence over the economic processes that occur in this structure and in each member state.

It is well known that th*e fiscal systems are a key factor in the influence over any economy.* They determine the increasing of savings, investments and work, with influence upon the production efficiency, the labour force that represent essential elements in the economic strategy that make the fiscal reform a very important component of the economic reform.

Romania crosses a period when the fiscal reform is in development. The main purpose is to eliminate the failures of the former reforms and to give efficiency and balance that characterize the optimal fiscal systems. Romania is also involved in a process of European integration where a major element is the adjusting of the fiscal legislation by taking into account the social, political and economic structures of the country. These aspects offer the article a current *context,* that will be useful both theoretically and practically in further scientific investigations as a consequence of the complexity of the fiscal problems related to this thesis. The research theme counts with a large area of problems regarding the fiscal system in our country with its main two piles the direct taxes and the indirect taxes, the Law 571/ 2003 regarding the Fiscal Code and the implications of the unique tax, the economic reforms and the implications of the fiscal policies upon the economic development in the EU. Such a complexity allows the identification of fundamental elements in this research. So the fiscal factor can be considered as fundamental in this research regarding the impact over the stability of the economic development.

2. The role of fiscal policy

The role of fiscal policy—the national government's planned, discretionary balance between its outlays and recurrent revenues (broadly, spending and taxes)—has long been a subject of debate and controversy in modern times. During the 20th century, for a time at least, a 'Keynesian' view of the role of fiscal policy supplanted the more traditional conservative view. The latter view took as its benchmark a rather thorough-going commitment to the maintenance of a balanced budget—aggregate spending being restricted to the size of aggregate recurrent revenue—with a view to the objective of sound management of the government sector's 'balance sheet'. Or to put the same point differently, budgets were to be framed with a view to prudent management of the State's assets, financial liabilities and net worth—generally with a presumption in favour of 'small government'.

This approach does not inexorably lead to the policy conclusion that there ought to be continuous annual balancing of outlays and recurrent revenue: it is consistent, for example, with balancing the 'current' budget (recurrent expenditures equal to recurrent revenues), while funding capital expenditure with issue of financial liabilities (government debt). For in this way, at least if sensibly done, the value of assets would increase with the extent of financial liabilities, with no deterioration in the public sector's net worth. Nevertheless, in practice the credo of the balanced budget was the common mantra. And in truth, the illiquidity of government assets, and their commonly non-revenue-generating character, means that funding assets with debt is not a straightforwardly viable financial exercise.

The role of fiscal policy in developed economies is to maintain full employment and tabilize growth. In contrast, in developing countries, fiscal policy is used to create an environment for rapid economic growth. The various aspects of this are:

1. Mobilisationm of resources: Developing economies are characterized by low levels of income and investment, which are linked in a vicious circle. This can be successfully broken by mobilizing resources for investment energetically.

2. Acceleration of economic growth: The government has not only to mobilize more resources for investment, but also to direct the resources to those channels where the yield is higher and the goods produced are socially acceptable.

3. Minimization of the inequalities of income and wealth: Fiscal tools can be used to bring about the redistribution of income in favor of the poor by spending revenue so raised on social welfare activities.

4. Increasing employment opportunities: Fiscal incentives, in the form of tax-rebates and concessions, can be used to promote the growth of those industries that have high employment-generation potential.

5. Price stability: Fiscal tools can be employed to contain inflationary and deflationary tendencies in the economy.

Fiscal policy has been a great success in developed countries but only partially so in developing countries. The tax structure in the developing countries is rigid and narrow. Thus, conditions conducive to the growth of well-knit and integrated tax policies are absent and sorely missed. Following are some of the reasons that are hindrances for its implementation in developing countries:

1. A sizeable portion of most developing economies is non-monetized, rendering fiscal measures of the government ineffective and self-defeating.

2. Lack of statistical information as regards the income, expenditure, savings, investment, employment etc. makes it difficult for the public authorities to formulate a rational and effective fiscal policy.

3. Fiscal policy cannot succeed unless people understand its implications and cooperate with the government in its implication. This is due to the fact that, in developing countries, a majority of the people are illiterate.

4. Large-scale tax evasion, by people who are not conscious of their roles in development, has an impact on fiscal policy.

5. Fiscal policy requires efficient administrative machinery to be successful. Most developing economies have corrupt and inefficient administrations that fail to implement the requisite measures vis-à-vis the implementation of fiscal policy.

Among the various tools of fiscal policy, the following are the most important: **Reflationary Fiscal Policy.** It may be used to boost the level of economic activity during periods of recession or deceleration in economic activity. This is done by lowering taxes or increasing government expenditure.

Deflationary Fiscal Policy. During a boom, i.e., when the economy is growing beyond its capacity, inflation and balance of payment problems might result. This can be achieved by increasing taxes or by reducing government expenditure.

It would perhaps be too simplistic to conclude that fiscal policy is the most important tool of financial correction and consolidation, especially that undertaken by the government. However, there is no reason to neglect this very powerful tool that is in the hands of governments and central banks the world over. Used properly, fiscal policy can determine the broad direction the economy of a given country is going to take.

The role of fiscal policy - Automatic stabilizers and discretionary fiscal policy

As economic activity fluctuates, fiscal expenditures and taxes respond automatically in ways that stabilize the economy. For example, during an economic slowdown, government spending on unemployment benefits rises automatically as the unemployment rate rises.This increase in spending is automatic in that it does not require explicit actions by Congress or the President. Similarly, tax payments decline automatically when the economy goes into a recession. Auerbach and Feenberg (2000) have estimated that automatic tax stabilizers offset about 8% of the impact of an economic shock to GDP.

While the automatic adjustments of federal spending and taxes work to stabilize the economy, not all automatic fiscal adjustments are stabilizing. State and local governments also see their tax revenues fall during recessions, but, because many of these governments must balance their budgets annually, they often must cut spending during recessions. In addition to the automatic responses of fiscal policy, governments may make discretionary fiscal changes in the face of an economic downturn.

Expansionary fiscal policy aims to boost demand and output in the economy either directly, through greater government expenditures, or indirectly, through tax reductions that stimulate private consumption and investment spending.The standardized surplus provides a good way to measure these discretionary changes by correcting the actual budget surplus for changes due to the effects of automatic stabilizers.

Expectations of future fiscal actions, and not just current expenditures and taxes, also can affect the economy.The distinction between current changes in spending or taxes and expected future changes is important because households and firms consider future economic conditions, as well as current conditions, in making their spending decisions.The impact of a change in fiscal policy today will depend on how it affects individuals' expectations about future government spending and taxes.

A tax cut, for example, leaves more disposable income in the hands of households. If the tax cut is viewed as temporary, though, it may have a much smaller effect on household spending than a permanent tax cut would. In contrast, some temporary tax changes can have larger effects on spending than permanent changes. For example, an investment tax credit that temporarily lowers the cost of investment projects can lead firms to schedule their spending to take advantage of the tax credit. Both current and future fiscal actions must be considered in assessing the impact of fiscal policy on the economy.

3. The evolution of fiscal revenues in Romania

The argument of the economic calculations used by the fiscal policy is given by the arbitrary feature. What are the reasons for which the government suggested the shift from progressive quotas on income installments to the unique quota of 16%? Why 16%? The natural question refers to the way income quotas are set up; to the way of emphasizing the best tax that helps the economy flourish and go for the better. Yet, in practice, the reason of any fiscal system is not and cannot be objective. It is neither ensuring the "good running" of the economy, nor reducing the taxes' collection costs, as fiscal authorities often show. The fiscal regime is more often subject to discretionary budget needs and political interests, in a world where most specialists keep talking about "fiscal optimization" like an illusion.

During the debates upon the nature of fiscal regime, specialists have precisely left aside the essential element: the general fiscal burden. The real issue does not relate to the progressive or proportional taxing method, but to the general level of taxing. This is an issue that primarily relates to ethics and secondly to efficiency.

The efficiency of tax cashing depends on several factors among which, especially in our country, the most important are : legislation stability, issuing regulatory acts and their clear implementation norms that should not produce misunderstandings; the reduction of government expenses that are unproductive and non-economic; discouraging tax evasion and removing underground economy; a quicker compliance of the fiscal legislation within the European Union.

Analyzing the effects of the 16% quota in Romania in order to identify the relationship between that fiscal step and the government's practical ability to set up the level of the 'best' taxing rate, one can notice that the goal has been accomplished at least from the perspective of fiscal authority.

Evolution of fiscal revenues in Romania during 2000-2009*

Table 1:

Years	Fiscal revenues (million Lei, current prices)
2000	**23504,8**
2001	**32669,9**
2002	**41816,6**

2003	**53248,2**
2004	**66678,3**
2005	**78281,4**
2006	**96773,9**
2007	**115208,8**
2008	**124467,0**
2009*	**43841,1**

Source: Made by the author with data from www.mfinante.ro

* - The data for the year 2008 include the fiscal revenues achieved during January-February.

It can be noticed that even if on 1st January the single quota –16%- started being applied for most incomes of individuals and businesses, a quota that replaced the progressive taxing (the quotas between 18% and 40% applied in income installments), of individuals' incomes and the 25% quota of businesses' incomes, the fiscal cashing went up from 66,678,3 mil. Lei in 2004 to 78,281.4 mil. Lei in 2005.

In an interview about the single tax in Romania in the "Capital" newspaper, Arthur Laffer, the author of the famous curve that bears his name, the advocate of the theory saying that small taxes stimulate productivity and economy, stated: "The single quota is going to solve many corruption matters because, if it is applied on a large basis, it can lead to the existence of few incentives to break the law. Yet, at the same time, a fiscal amnesty is necessary, which is very difficult. How can you solve all the crimes of the previous fiscal regime when you replace a corrupted system by a mere one? You must start from nothing, but it is very hard". And he also asserted about the fiscal optimization: "The idea is to collect taxes in the least harmful way and spend them in the most profitable way (…); the most important lesson is not to pay people who do not work and not to tax those who do"[1].[Arthur Laffer, 2005]

In a comparative analysis of the public revenue share of GDP in all the European Union member states, one can get a confirmation of the moderate level of fiscality in Romania:

Public financial resources of EU countries (share of GDP and per capita) during 2000-2006

Table 2:

	Public resources-share of GDP							Public resources/capita in Euros						
	2000	2001	2002	2003	2004	2005	2006	2000	2001	2002	2003	2004	2005	2006
EU-27	…	…	44.4	44.4	44.2	44.7	45.2	…	…	9,054	9,161	9,520	9,980	10,605
EU-25	45.8	45.1	44.5	44.5	44.2	44.8	45.3	9,208	9,411	9,588	9,700	10,070	10,538	11,182
BE	49.1	49.6	49.8	51.1	49.1	49.9	49.1	12,072	12,496	12,900	13,534	13,655	14,211	14,623
BG	…	…	39.6	40.3	42.0	41.6	40.3	…	…	839	917	1,075	1,179	1,317
CZ	38.1	38.7	39.5	40.7	42.2	41.3	40.7	2,281	2,617	3,101	3,230	3,649	4,051	4,518
DK	56.5	56.0	55.4	55.6	57.3	57.8	56.2	18,374	18,737	19,052	19,429	20,789	22,205	22,756
DE	46.4	44.7	44.4	44.5	43.3	43.5	43.8	11,650	11,482	11,548	11,657	11,614	11,848	12,350
EE	36.2	35.0	36.0	36.4	35.9	35.4	36.6	1,611	1,772	2,052	2,337	2,534	2,941	3,602
IE	36.3	34.3	33.2	33.8	35.2	35.4	37.1	9,987	10,398	11,014	11,820	12,886	13,785	15,246
EL	43.0	40.6	40.0	39.3	38.2	38.0	39.5	5,428	5,463	5,738	6,104	6,388	6,804	7,610
ES	38.1	38.0	38.4	38.2	38.5	39.4	40.4	5,987	6,348	6,780	7,115	7,590	8,256	8,992
FR	50.2	50.0	49.5	49.2	49.6	50.7	50.8	11,901	12,239	12,434	12656	13,177	13,858	14,408

[1] Arthur Laffer: "Fiscal amnesty is a necessary step", Capital, 18 May 2005

IT	45.3	44.9	44.4	44.8	44.2	44.0	45.6	9,479	9,843	10,055	10,380	10,566	10,677	11,435
CY	34.7	35.9	35.9	38.6	38.8	41.2	42.7	5,035	5,532	5,637	6,281	6,660	7,419	8.049
LV	34.6	32.5	33.4	33.2	34.7	35.2	37.0	1,238	1,286	1,414	1,423	1,679	1,993	2,613
LT	35.9	33.2	32.9	32.0	31.8	33.1	33.4	1,267	1,294	1,425	1,523	1,679	2,006	2,338
LU	43.6	44.2	43.6	42.4	41.3	41.7	39.7	21,855	22,616	23,459	24,130	24,761	26,897	28,421
HU	43.6	43.2	42.4	41.9	42.4	42.1	42.6	2,220	2,522	2,948	3,091	3,457	3,714	3,806
MT	34.8	36.6	37.7	37.9	41.0	42.0	41.6	3,769	4,007	4,274	4,208	4,576	4,929	5,148
NL	46.1	45.1	44.2	43.9	44.3	44.9	46.7	12,113	12,586	12,738	12,920	13,377	14,002	15,257
AT	49.8	50.7	50.0	49.3	48.9	48.2	47.8	13,073	13,615	13,662	13,738	14,136	14,372	14,893
PL	38.1	38.6	39.2	38.4	36.9	39.0	40.1	1,847	2,145	2,150	1,926	1,975	2,499	2,855
PT	40.3	40.1	41.4	42.5	43.1	41.7	42.5	4,803	5,037	5,404	5,647	5,919	5,877	6,225
RO	**43.8**	**36.7**	**37.6**	**32.1**	**31.2**	**32.2**	**33.2**	**788**	**736**	**835**	**776**	**875**	**1,185**	**1,492**
SI	43.6	44.1	44.6	44.4	44.2	44.5	44.1	4,634	4,969	5,395	5,635	5,921	6,285	6,682
SK	38.3	37.8	36.6	37.7	35.6	35.6	33.9	1,569	1,656	1,772	2,051	2,241	2,519	2,767
FI	55.2	52.7	52.9	52.4	52.3	53.0	52.5	14,119	14,212	14,636	14,668	15,237	15,888	16,670
SE	60.9	58.3	56.6	57.2	57.5	58.7	57.9	18,026	16,218	16,417	17,205	17,974	18,714	19,511
UK	41.2	41.5	39.9	39.5	40.0	41.2	41.9	11,005	11,332	11,279	10,729	11,656	12,336	13,229
IS	43.6	41.9	41.7	42.8	44.2	47.6	45.9	14,596	12,982	13,740	14,373	16,113	21,039	19,981
NO	57.7	57.4	56.3	55.5	56.6	57.4	58.7	23,447	24,299	25,297	24,198	25,661	30,127	33,665

Source: Eurostat, Economie et finance, Statistique des administrations publiques

The above table shows the size of the public administration sector in each European Union member state.

Our country has the lowest income tax in all the European Union. Almost the same can be said about profit taxes that are among the lowest in the European community. It is for these reasons that the tax revenues' share of GDP is small. Practically, in 2005, Romania recorded the lowest level of revenues from taxes and fees as compared with the countries in the European Union.

According to a survey made up by Eurostat[2], the European Statistics Department, Romania had in 2007 the lowest income tax of all the 27 European Union member states, which is 16%. At the opposite side there are Denmark and Sweden that have an income tax of 59%, respectively, 56.60%. As far as the European average income tax is concerned, it is 38.68%, whereas the average in the Eurozone is 45%. [Wozowczyk Monika, 2008]

Romania relatively has the same level of profit taxes, too, that is still 16%, but it is not the lowest. The lowest profit taxes are in Bulgaria, Cyprus, each having 10%, Ireland (12.5%) and Latvia (15%). Romania ranks fifth, after those countries. In the other part of the chart, having the highest profit taxes, there are Denmark (38.7%), Italy (37,3%) and Malta (35%).

Yet, a relative fiscality approach does not have a practical relevance without the connection with its real approach. The 33% rate in 2006 in Romania and 56% in Denmark or Sweden (within the same periods) are not comparable because their basis is different: Romania's GDP in 2006 at purchase parity was 192.96 billion Euros that is equal to 8,900 Euros/inhabitant. The figures rank Romania the 26th (last but one) among the European Union member states that had an average GDP/capita at purchase parity of 23,600 Euros. Hence, the conclusion that both the fiscality

[2] Wozowczyk Monika, Paternoster Anne, Lupi Alessandro – "Statistique en bref 23/ 2008", Economie et Finances, Eurostat, 2008

supporting power and the real effects of promoting a certain fiscality rate are higher in those countries than in Romania[3]. [Andrei Citlaru, 2007]

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4. Conclusion

Automatic fiscal stabilizers help moderate economic fluctuations.The contribution discretionary fiscal policy can make in combating economic recessions is more debatable.The long lags that typically characterize major changes in fiscal policy weaken the role discretionary policy can play during the relatively short recessions the U.S. has experienced. In some cases, the direct impact of current fiscal spending and taxation may be reduced or even offset as households and firms react to the expectation of future fiscal actions.

The efficiency of tax cashing depends on several factors among which, especially in our country, the most important are : legislation stability, issuing regulatory acts and their clear implementation norms that should not produce misunderstandings; the reduction of government expenses that are unproductive and non-economic; discouraging tax evasion and removing underground economy; a quicker compliance of the fiscal legislation within the European Union.

As a conclusion, fiscality, although never to be popular, is objectively necessary ; the issue is to design a fiscal system to diminish social losses and achieve equity goals that are socially accepted at a given time.

[3]www. eurostat.ec.europa.eu (Andrei Ciltaru: In 2006, Romania reached 38% of the EU'S average wealth level, Bloombiz, 27 June, 2007)

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