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APPLYING FISCAL IMPULSE IN ROMANIA IN PERIOD 2002-2013: DECREASING FISCAL PRESSURE VERSUS RISING TRANSFER PAYMENTS

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Abstract:

The first goal of a market economy is to obtain and preserve, in long term, economic growth; for this goal, there are a number of tools – macroeconomic policies, there is: fiscal policy, monetary policy, budgetary policy, etc. – at disposal of policy makers, so as to make such a project come true.

This is not so easy, however: all these tools must be carefully calibrated and carefully used. One of the most important policy is fiscal policy (which can be defined, in brief, as the sum of all measures, procedures, tools and policies a government uses so as to modify, to its liking, macroeconomic outcomes); an important tool, also, is monetary policy – which tinkers, so to speak, with money, in ***all*** *its forms and shapes.*

This paper, however, it is not limited to simply assess, theoretically, best uses for fiscal policy; it aims to analyze, meaningfully, the effectiveness of fiscal policy in Romania, between years 2002 and 2013, in order, not only to state what did go wrong with it in that interval, but to establish best ways in which, in Romania, fiscal policy – and monetary policy – can be put to best use, inclusively in order to do what is to be done for achieving long-lasting economic growth in the future.

Key words: fiscal policy, impulse, taxes, economic growth, interest rate

JEL classification: E01, E17, E27, E43, E65

INTRODUCTION

Market economy, in our time, face a harsh economic environment, and, as such, have to solve difficult dilemmas – if they are to take difficult decisions. And, first goal of any market economy being obtaining and preserving, in long term, *economic growth* (Schiller, 2008), all the tools at their disposal must be carefully calibrated and even more carefully used.

One of the most important tool – or policy, in this case – is fiscal policy; an important tool, also, is monetary policy. Both policies must be enforced conjunctly, to attain maximal results, given a strategic goal – such as the goal named in previous paragraph – exists, and that it is pursued not only on paper, but in practice.

Fiscal policy can be put to good use, for the entire economy, and on long term; for example, working with fiscal policy through tax cuts can boost the economy by means of increasing investment spending – or, simply, spending (and, thus, consumption) in general.

Conversely, fiscal policy can be used – just as monetary policy can also be used – for day-to-day affairs, in general for *short term objectives*. These are, of course, important, but employing macroeconomic policies in order to obtain only minor (if positive) outcomes not only comes into conflict with the very principles, ideas and targets these policies were designed in the first place, but because it can cause great damage to market economy a policy such as fiscal policy is called into action to best manage.

Romania, in the period 2002-2013, recorded both good times and not so good time for its economy: between 2002 and 2008, maybe even between 2004 and 2008, economic growth manifested itself, but it was not as beneficially as would have been expected, since it was largely conjectural (i.e. 'built on' a roller coaster expansion of real estate sector of Romanian economy).

As a result, Romanian benefit did not benefit from it as much as it would seem. After 2007, present economic and financial crisis set itself in Romania as well, with well-known results. Finding and assessing what fiscal economy, in particular, did in order to 'smooth the edges' is the main focus of this paper.

CONTENT

Fiscal policy is a very important tool, in order to achieve – and to consolidate – economic growth; this is true in any economy, but especially in a somewhat less-than-perfect operated economy – as almost any market economy from states affected by present economic and financial crisis, and, it goes without saying, as Romanian economy.

Considering both economic *growth* targeting – as much or as real as it was, and is, done – and policy making, it is worthwhile to analyze the last decade – and especially 2002-2013 period – in order to ascertain the results fiscal policy had, in more or less distant (economic) past, on economic mechanisms of Romania, on one side, and on Romania's economic growth, on the other side.

Economic growth is, in short, the recorded growth (i.e., algebraically, **positive** growth) of *national income* (e.g. GDP – Gross Domestic Product) – for a given state/economy (Schiller, 2003). For this goal to be attained, various economic policies can be and *are* used, most important being, in this respect, fiscal policy and monetary policy.

Both policies are used and must be used, because economic growth is a state of economy in which rise, simultaneously, and – *exempli gratia* – in long term:

(a) Aggregate demand;
(b) Aggregate supply.

The economic and mathematical background is that national income can be described, either as a sum of ***expenses*** – in which case one refers to the aggregate demand 'side of the story', or as a sum of ***revenues*** – in which case, the 'side' is that of aggregate supply (Schiller, 2003). Whatever the case may be, in other words no matter in what manner one computes national income, this income is, *either way, one and the same*.

Each policy, of those named above, has a part in this: fiscal policy is used to increase aggregate demand, through sending a ***fiscal impulse***; this impulse can be 'emitted' in three ways – two of them, and most important, are included in the title of this paper –, that is, either (Predescu, 2013):

(a) by increasing government spending, or
(b) by decreasing tax rates, or, respectively,
(c) by increasing amount of transfer payments.

An observation is required here: if fiscal impulse is emitted through decreasing tax rates, what is actually decreased is, more specifically, (*total*) tax ***pressure***.

In turn, monetary policy is applied in order to – finally – increase aggregate supply, and this through sending a ***monetary impulse*** – that is, through decreasing the interest rate (Lipsey and Chrystal, 2004). Producers will be able, thereupon, to borrow money more easily, so that they will be able to increase output of goods and services – in other words, aggregate supply will increase.

Economic growth, therefore, is built on consumption, as far as consumers are concerned, and, respectively, on investment – as regards producers. This mechanism, described above, can be properly rendered 'in brief' graphically, as follows (where C stands for consumption, I for investments, E for savings, CA denotes aggregate demand, OA denotes aggregate supply, V denotes income and d denotes interest rate) (Predescu, 2013):

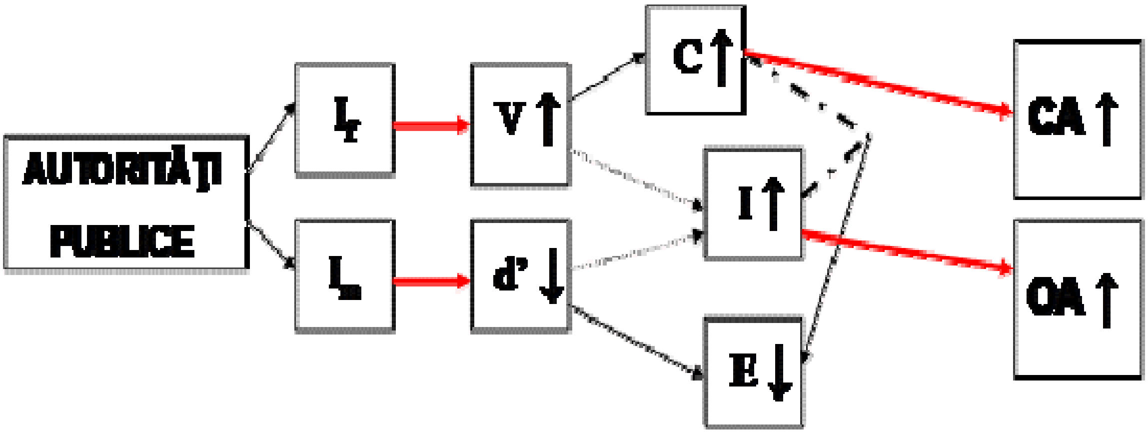

Figure no. 1

Source: Antoniu Predescu, *Impozitarea veniturilor şi creşterea economică*, Editura Universitară, Bucureşti, 2013, p. 75

Returning, however, to the issue of increasing aggregate demand, it is worth underlining the undeniable fact fiscal impulse needs a properly 'tuned' economic environment, in order to function properly, or, in other words, to reach its goal(s).

Firstly, inflation: a fiscal impulse is going to be useful *if* price level stays constant, or, eventually, only slightly increases; in other words, it is known that, along with economic growth, ***full employment*** can be achieved as an effect of an increased GDP – in its turn, the main effect of a rise in aggregate demand.

Secondly, one shouldn't forget a fiscal impulse has a two-tier system of working on the economy: in first phase, there is the *initial* fiscal stimulus, but there is also a second phase, that of induced boost of consumption, due to multiplier process. And here, there are two observations standing out: one is the fact this mentioned second phase happens at price level of first phase; the second observation is emitting a fiscal impulse through decreasing tax rates is hoping for more than one is about to receive.

The reason is whilst consumers will possess *larger* (net) incomes than before the tax reduction, not ***all*** that money is going to be actually spent: a large share of net income will be spend, but by no means all; a sizeable proportion of incomes will be saved.

Of course, if the fiscal impulse is to be efficient, policy makers must emit, in advance, a proper monetary impulse, as we have observed already: smaller interest rates will, undoubtedly, limit size of savings.

In addition, it is useful to note both fiscal impulse and monetary impulse can and should built up, *together*, an economic environment favorable for investments: for this, higher *net* incomes (e.g. after a corporate tax cut) coupled with small(ler) interest rates seem to be the right mix. This mix is, by the by, starting point of a new multiplier effect – that of additional investment entering the economic mechanism.

This is as much as economic theory goes. Practice can be slightly different, as we will shortly see. That is, given reality is the very best testing ground of any theory, it is most useful to produce the following figure, from which the main points, as regards the effectiveness of fiscal policy in Romania, between years 2002 and 2013, can be identified and summed up in:

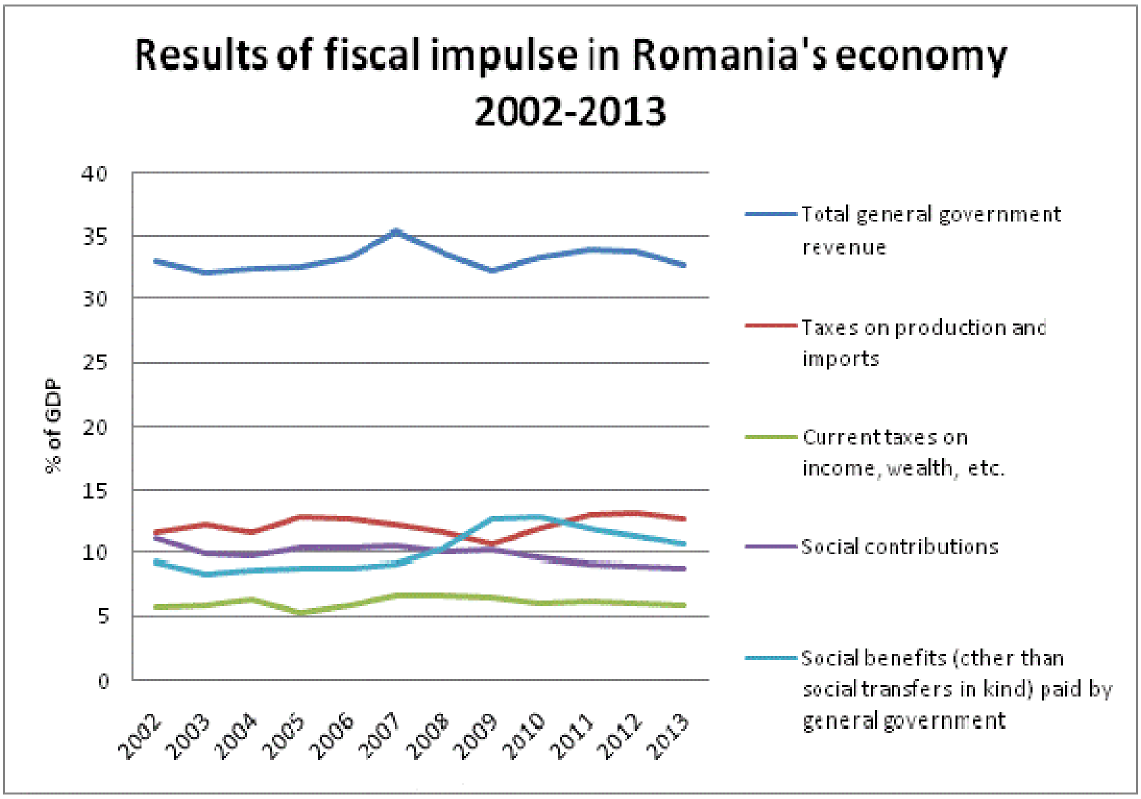

Figure no. 2

Source: authors' own computations, using data from www.eurostat.org

We should first note all indices in figure above (figure no. 2) are relative ones – i.e., defined as % of GDP. One of the most important indices pictured in this figure is one describing (indirectly) effectiveness of fiscal policy in Romania – Total general government revenue.

As observed, its dynamics, in this interval – 2002-2013 –, is rather erratic, a maximum being recorded in 2007 – just *before* Romania's economy joined 'The Crisis Club' of economies plunged in current economic and financial crisis – and *the* minimum in 2009. Since then the situation ***should have*** recovered, but it is plainly visible in 2012 and 2013 things turned out badly – again.

General government revenue consists, for the most part, in Romania, at least, of fiscal revenues. *Its* evolution, in Romania, suggests, already – 'already', given the fact it is a synoptic index, so to speak – embodying dynamics of all the other fiscal indices analysed here –, that fiscal impulses were emitted, in Romania' economy, but were not exactly perfectly calibrated for economic reality here.

Taxes on production and imports – VAT, excises, etc. – recorded a minimum in 2009, after a rather tortuous evolution, and dropped, again, in 2013, as of 2012. These taxes are taxes levied on consumption; thus, a fiscal impulse, if it is emitted at all, is emitted so as to boost consumption, and – finally – aggregate demand.

In order to depict the situation completely, we must remind the fact VAT rate rose, rather sharply, from 19% to 24%, in 2010, decision which can hardly be regarded as implementing/emitting a fiscal impulse.

In addition, it is worth glancing over the above figure (figure no. 2), for anyone can see there the level of indirect fiscal pressure (= computed as amount of tax paid to state fiscal system by taxpayers relative to size of GDP) is sensibly higher than level of direct fiscal pressure – at least in the period 2002-2013.

Social benefits (e.g. **second emission path of tax impulse**) exhibit a maximum in 2009, and generally speaking an upward trend since 2009 – which, at least in part, can be attributed to political 'crisis management'; anyway, this can be considered as being a *genuine* fiscal impulse.

Not least important, (current) taxes on income, wealth &c. prove to have maintained a more or less constant level between 2002 and 2013. In Romania, global income tax was introduced for the very first time in 2005, more or less in the role of 'universal medicine' – but, so far, without any 'wonder' results.

CONCLUSIONS

In 2002-2013 period Romania had, indeed, a fiscal policy, even a proper fiscal policy – not a fiscal policy *of sorts* –, but this is about all that can be said favorably about it. The reason for such a conclusion for our part is simple: fiscal policy, as well as any other similar (macro)economic policy enforced by government of any market economy, is used, even more, *designed* so as to help/boost ***the economy***, not – or not only – general, or state, budget.

Boosting the economy, in other words – *exempli gratia* – promoting and pursuing economic growth, this is definitely what fiscal policy – and monetary policy, not in the least – is, finally, all about.

Fiscal policy in the role of 'helper' of budgetary policy is compatible with any political man or party wanting to win (again) over its constituencies, but this is, in the end, hardly in favor of these very constituencies: conjectural (and) electoral 'bribery' cannot help anyone in the long term.

In Romania, in this period (2002-2013), fiscal policy emitted indeed fiscal impulses, and powerful impulses at that, but with little strategic insight; this is, however, in part, at least, excusable, since the present economic and financial crisis, which started to affect deeply Romania since, let's say, 2008, hit hard whatever economic growth Romania's economy recorded, with or without help coming from fiscal policy.

But, of course, this circumstance should have *enforced* fiscal policy as a really strategic tool, not otherwise. This is the point where main use, so to speak, of this paper becomes really visible: we can and do underline not only what imperfections characterized fiscal policy in Romania, between 2002 and 2013, but, much more important, what is to be done in the future, in order for fiscal policy to become what it should be.

Romania has, all along since 1990, a strong preference for indirect taxation – i.e., for taxes on production and imports –, due to straightforward reasons: in this field, tax evasion is a remote possibility, and, even more important, taxes are collected just by using minimal resources (such as money, labor, etc.).

The 'only' problem associated with over-using consumption taxes is, whilst successfully promoting – and in long term – consumption (of goods and services) is literally the cornerstone of achieving, also in long time, economic growth, such a fiscal policy is, due to very obvious reasons, very unlikely to achieve such goals.

Apparently, increasing size of transfer payments – in Romania, social benefits – should do the job fiscal policy is required to do; even more so, as, indeed, the *regime* of direct taxation, was, in this interval, relatively lax.

Once again, one confronts with the same problem: Romanian government badly needs money, and, in order to obtain them, it insists on squeezing consumption of all financial funds it can conceivably shed. So, what they give with one hand, they take, as like as not, with the other hand.

Summing all this up, we are of the opinion on one side, Romanian government, as well as any other government, knows only too well what is to be done, from a technical point of view, in order to achieve/consolidate economic growth, and also to build up a sound fiscal policy, sound enough even for obtaining economic growth. But, on the other side, there is an all too clear desire to avoid approaching difficult – that is, important – issues, in general *long term targets*.

In part, however, the crux of all these problems lies, also, in the realm of deciding *how* you are going to deal with taxpayers; if the state itself is run badly, those who run that state will obviously need to obtain the money *easy*, *fast* and *in large amount* – pretty much like any (other) thief or robber. Thus, the accent will strongly be put on indirect taxation, since no taxpayer can show too much frustration and anger, if any, anyway.

So, the remedy is easily reachable: simply put, a sound fiscal policy can exist, even in short term, only in a sound-run state, who 'knows' what it 'wants' and 'wants' what is really useful for it, state running a market economy to match.

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