Coordinates of fiscal policy in times of crisis and their efficiency

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Abstract. The paper treats the fiscal policy in the preceding years, but during the economic crisis. Also the Laffer curve for Romania was determined, putting into evidence the Romanian fiscal policy incoherence.

Keywords: Laffer, crisis, tax, fiscal

1 The fiscal policy

The role of fiscal policy in economic and social terms, is one of great importance, especially in the current context characterized by instability when taxes are the main levers that act as automatic stabilizers of economic growth in order to mitigate business cycle fluctuations.

The role of automatic stabilizers is particularly important, helping to smooth the business cycle and lower GDP volatility. Mechanism is more effective in progressive tax systems. The role of these stabilizers is visible also in the flat tax system, such as Romania in 2004. Budget balance through cyclical fluctuations contributes automatically to smooth fluctuations in economic activity:

1. Automatic stabilizers reduce (without intervention makers) the amount by which GDP changes in response to a shock in the economy;

2. During the boom, the budget records a surplus and vice versa;

3. It decreases the population preference for liquidity during the economic boom and increased during the recession;

4. It stimulates the aggregate demand when the economy is on the descending slope of the economic cycle and limits its expansion during the boom.

A factual situation found in most economies, not only in Romania, is that during the boom, when actual GDP was above the potential, significantly increased the structural deficit by blocking the action of automatic stabilizers. The deciders committed to structural expenditure (permanent) based on cyclical income (temporary).

The efficiency and size of automatic stabilizers depends, in addition to the tax system also by government expenditure share in GDP ([1]). They may have a countercyclical effect by stabilizing influence on the economy to prop up aggregate demand by increasing unemployment benefits during the period of recession when unemployment is rising.

Romania’s fiscal policy was pro-cyclical, discretionary, not having the ability to mitigate macroeconomical imbalances.

Some of the priorities of decision makers in Romania, and in most European countries, are the excessive pressure on the budget deficit and growing public debt it carries on economic growth.

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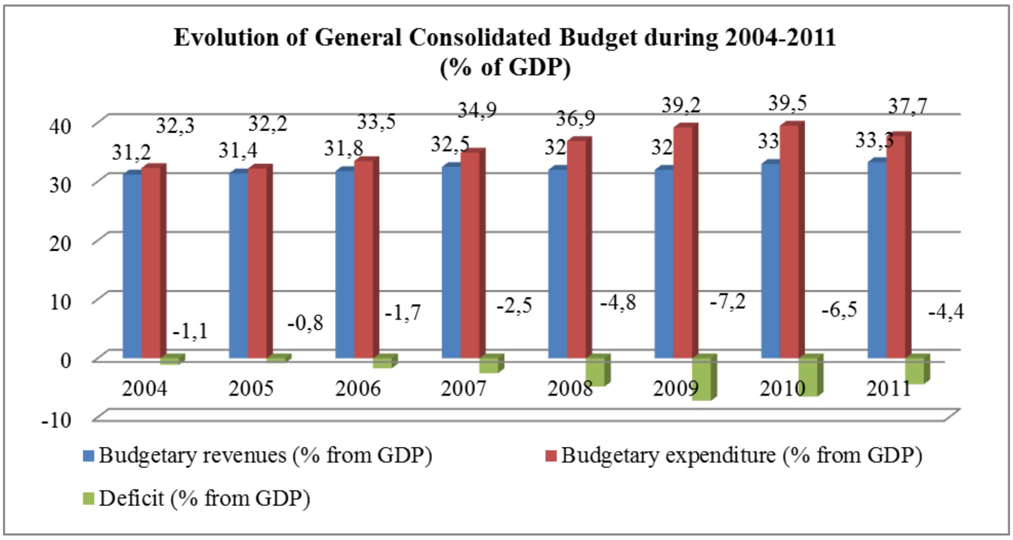
Economic policies during the boom, 2004-2008, were neither Keynesian type, restrictive in periods of expansion, but were within nor neoclassical model, their neutrality during the economic cycle, demonstrating once again the propensity developing countries to pro-cyclical fiscal policy ([4]).

In the period 2004-2011 (the period of growth followed by economic crisis), the general government had the following evolution:

Figure 1



Source: Ministry of Finance

From the economic policy mix, the component with the highest degree of uncertainty was the tax. During the period 2004-2011, fiscal policies have contributed to widening budget deficit from 0.8% of GDP in 2005 to 7.2% in 2009 and increasing public debt. How necessary macroeconomic adjustment measures were not applied in time, the Romanian economy has recorded much later the first signs of growth compared to other European countries.

To finance the budget deficit were used both internal and external sources, aiming to maintain a sustainable level of debt both public and costs. Domestic financing was done by issuing government bonds, treasury bills and bonds respectively.

Fully funding the budget deficit was also achieved by issuing securities and foreign capital markets, but also by pulling installments by the Ministry of Finance of the financial package agreed by the International Monetary Fund, the European Community and the International Bank for Reconstruction and Development (institution from the structure of the World Bank):

- Loan to finance the state budget deficit amounting to 1.5635 billion SDR in the total of 11.443 million SDR granted to Romania by the International Monetary Fund in 2009;
- Loan to finance the state budget deficit and government debt refinancing worth 3.65 billion euros of the total of 5 billion granted to Romania by the European Community in 2009;
- Loan to finance the budget deficit of 300 million out of 1 billion euros to Romania by the International Bank for Reconstruction and Development in 2009.

Pillars to achieve healthy budget construction are primarily restructuring public expenditure on the maintenance at sustainable levels and secondly, the movement towards investment expenditures.

Under such conditions, macroeconomic environment in Romania will be perceived as stable and predictable by domestic and foreign investors.

In 2009-2012, years of economic crisis, most countries have tried to improve the volume of budget revenues through changes in taxes in order to solve the economic problems they face.

Each Government shall make its own fiscal policy, number and size of the taxes being set in relation to the expected effects of changes in the economic cycle.

Income in the economy can be influenced by monetary policy, but to a greater extent also by the tax. As part of the economic policy measures affect the economy there are gaps. They may be from time, to assume that policy by decision makers (internal gaps) or timing while their effects on the economy (external gaps).

At the level of fiscal policy in relation to the monetary, the gap is shorter outside, but it is characterized by a gap inside longer. This makes fiscal policy be used sporadically in stabilizing the economy, its efficiency being lower ([4]).

The increasing or decreasing of the tax burden is the attribute of the state through its economic and social role in order to ensure the necessary resources for public spending, but also do not discourage businesses (taxpayers) to work, produce and invest.

2 The Laffer curve

The optimality of fiscal pressure generated interesting discussions among economists starting with Adam Smith who believed that certainty of taxation, tax collection and return their convenience are key principles of the tax system.

All of these resumed after by Arthur Laffer and, the exponent of the supply doctrine, according to which when a fiscal pressure is increased above a certain level, considered acceptable, this reduces the tax base and hence lower revenues to the state budget.

Laffer curve is divided into two areas, one considered optimal, because reducing the tax base is lower to the growth of tax burden and a second area considered prohibitive because any increase in the tax burden can not offset the reduction in the tax base ([3]).

Analysing the effects of tax burden on the Romanian general consolidated budget (total direct and indirect taxes without social contributions), from 2000-2011, we will try to determine the Laffer curve and its area when is positioned in the Romanian economy, the best or most prohibitive.

Table no. 1 Indicators used for modeling the Laffer curve

Year / Indicator	GDP in current prices (mil. lei)	Income tax (IT) in current prices (mil. lei)	GDP deflator (since 2000)*	GDP at constant prices of 2000 (mil. lei)*	Income tax (IT) in constant prices of 2000 (mil. lei)*	Fiscal Pressure (%) (IT/GDP)
2000	80984.6	1546805.9	1	80984.60	15468.1	19.1
2001	117945.8	2087640.7	0.727802	85841.19	15193.9	17.7
2002	152017.0	2645095.8	0.589791	89658.25	15600.5	17.4
2003	197427.6	3593182.3	0.475638	93904.04	17090.5	18.2
2004	247368.0	4477360.8	0.413598	102310.95	18518.3	18.1
2005	288954.6	5258973.7	0.368298	106421.27	19368.7	18.2
2006	344650.6	6479431.3	0.332399	114561.35	21537.5	18.8
2007	416006.8	8028931.2	0.294158	122371.72	23617.7	19.3
2008	514700.0	9624890.0	0.263582	135665.87	25369.5	18.7
2009	501139.4	8769939.5	0.247495	124029.61	21705.2	17.5

2010	522561.1	9667380.4	0.238895	124837.24	23094.9	18.5
2011	578551.9	11050341.3	0.223058	129050.57	24648.7	19.1

* Own calculations based on data from INSSE, World Bank, Eurostat

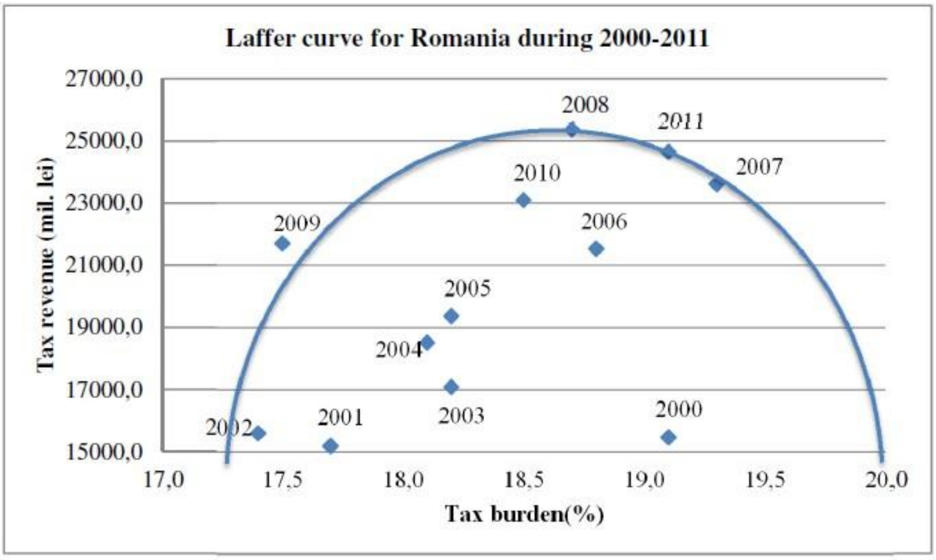


Figure 2

Looking at the chart above, the Laffer curve modeled using the tax burden and tax revenue (in constant prices of 2000) during 2000-2011, stands the Romanian economy also in the best area and in the prohibitive.

The maximum tax revenue was achieved in 2008, for a tax rate of 18.7%. At a tax rate higher than in 2008, we see that the tax base is reduces, business and individual initiatives being discouraged and expanding tax evasion, taxpayers opting for avoiding tax obligations fully or partially.

We note also that in 2000, 2006, 2007, 2011, the economic effect was superior arithmetic effect, when increasing the tax burden over 18.7% resulted in lower revenues. Arithmetic effect was economically superior to other years.

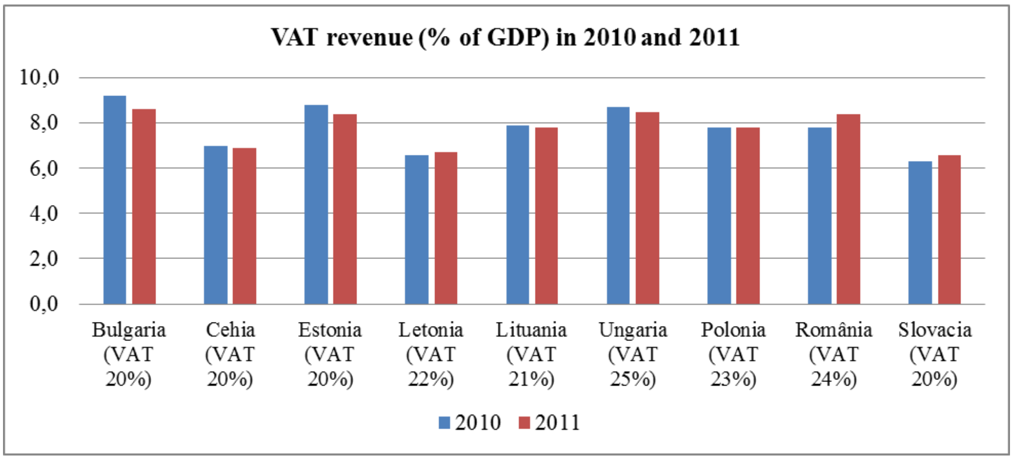
Tax reform in early 2005, when he moved to the flat tax, has not had the desired effect on tax revenues. In that year, the tax burden grew by 0.6% and 4.6% of fiscal revenues.

Similarly, the increase in value added tax from 1 July 2010 from 19% to 24% resulted in a range of negative effects on supply and demand of goods and services. The main risk of the VAT increase was in addition to reducing consumption and increasing evasion. More expensive excisable products made attractive not only circumvent paying taxes, but for those who collect taxes or even controlling authorities.

Unlike large companies that have taken it easier the difference of 5%, the increase of VAT leds to the bankruptcy of small businesses based on distribution services, shipping, transportation, usually intermediaries in the distribution chain.

Another issue requiring an urgent solution is inefficient administration of tax system in Romania being reflected in their poor collection. A major cause of poor collections is the existence of a reduced tax base with many exceptions and statutory deductions. Consider the collection of VAT revenue (% of GDP):

Figure 3



Source: Eurostat, Council Tax

Looking at the figure above, we see that the share of VAT revenues in GDP in our country, although it has a fairly large legal share, second after Hungary (25% in 2011) is less than or equal to that of countries the statutory rate is 20% or 21%.

Indirect tax collection deficiencies existed long before, reflected in economic developments, which are enhanced by previous measures.

3 Conclusions

Regarding fiscal policy, we conclude that fiscal pressure increases above the optimum leads to the following risks:

- Reduction of productive effort reflected in deterring legal work, saving and investment;
- Limiting consumption;
- Permanent transfer of the tax burden from consumer to producer ultimately leading to rising unemployment;
- Violation of tax laws and avoiding the payment of taxes;
- The increase of indirect taxes generates finally inflation.

In terms of mobility, increasingly higher, of international investment, Romania should reduce the tax burden to meet this competition, improve the effectiveness of tax collection related tax revenues actions, in the finally, to stimulate economic growth. Also a reduction of taxation will be accompanied by a simplification of it and a more severe in terms of escapist behavior.

4 References

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