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Theoretical budget and fiscal concepts applied to the Romanian public sector

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Abstract: *This paper examines the concepts of budgetary revenues and expenditures, public deficits and indicators of the efficiency of budgetary resources as applied to the Romanian public sector. The causes of public deficits and public debt are also investigated, with the associated tools and techniques used to finance them. Some policy recommendations are made – regarding a better collection of taxes to the state budget (based on the contributory capacity of the population and on the principle of equivalence) and a more prudent government intervention in the economy. A new approach to the fiscal policy is proposed, acting as an incentive to rethink it on a more sustainable and transparent base.*

Key-words: *public sector, fiscal policy, deficits*

1. Introduction

The topic chosen for analysis is of great importance, given all the debates related to fiscal responsibility. The Government is responsible to carry out the fiscal and budgetary policy and to manage budgetary resources, obligations and fiscal risks in a manner that ensures sustainability of the fiscal position in the medium and long term. As fiscal policies form a field of research that deals with public revenue and expenditure problems, the importance of the topic is reflected through the macroeconomic imbalances and lack of economic stability that Romania faced in the past years due to poor fiscal policies implemented in the last 15 years.

I chose to approach this subject because fiscal policies play a very big role in the economic growth and welfare of society.

The research objective proposed in this paper is to determine the impact of fiscal policy on economic growth. Before the economy crisis, the public sector implemented repeatedly the wrong fiscal policies that led to a decrease in economic stability. Nowadays, in Romania, the public sector is interfering more that it should in the economy, changing the fiscal policies implemented too often and without transparency.

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In terms of research methods, I studied the literature regarding fiscal policies and the role of the state in the economy and a comparative analysis of different fiscal policies implemented in Romania over the last 15 years.

This paper is structured as follows: the first section explains the role and the functions of the state in the economy. The second section reflects on the emergence of public debt and tries to show the role of budgetary deficits. In the following section I explained the role of fiscal policies and how they can influence the economy of a country; tools used to finance budgetary deficits were then set forth. The last section presents the conclusions regarding the effects of the fiscal policies on economic growth and budgetary deficits.

2. Literature review

Mishkin (1991) defined the crisis as being "the situation in which the adverse selection and moral hazard is growing, the markets are no longer being able to channel resources to the most productive investment opportunities."

The interventionist role of the state in the economy has emerged as a result of the process of societal development which has led to the emergence of new economic, social and political factors. The measures taken in this regard led to the passing under state control of certain categories of activities, including those that were considered to be of public interest" (Neagu, 2009).

The principle that the state should not interfere with economic activity was widely promoted by Adam Smith, a follower of liberalism and non-intervention. The doctrine was based on the principle of self-regulation of economic slippages without the intervention of the state through legislation or fiscal-budgetary measures. This kind of intervention could lead to inefficiency and the creation of more economic damages through poor administration

Nautet and Meensel (2011) argue that the impact of fiscal policy on economic activity depends heavily on certain circumstances, which may vary considerably over time from one country to another.

3. Objectives

The main objective of the paper is to analyse and explore the effects and efficiency of the policies applied by the Romanian public sector through the prism of theoretical budget and fiscal concepts.

4. Methodology

The methodology used is based on the study of specialized literature regarding the role of the state in the economy, fiscal and budgetary policies, the public debt theories and the analysis of the decisions taken by the Romanian public sector regarding budget and fiscal concepts.

5. Concepts on the role and functions of the state in the economy

The economic crisis of 1929-1933, known as the "overproduction crisis" or "the big economic crisis" was characterized by a dramatic decline in world economic activity. At that time, the economy did not adjust itself by its own mechanisms. On the contrary, as a result of this crisis, unemployment and inflation increased rapidly: the unemployment rate rose as a result of the decline in economic activity. At that time, the interventionist economy supported the state's intervention in the economy through various levers leading to market stabilization and the prevention of economic slippages gained followers. The principles supported by John Keynes (1883-1946), a major representative of the interventionist considerations, were adopted by many states after the Great Depression. This translated as the involvement of the state in the process of redistribution of public money and the use of various levers to influence the fluctuations of the economy. These levers relate mainly to fiscal policies (procyclical and countercyclical), investments, subsidies, transfers of funds, loans, the creation of companies with public capital.

The state's implications in the economy can take place at both microeconomic and macroeconomic levels. As far as the interventions at a microeconomic level are concerned, they refer to legislation that applies to the activities of the companies, laws aiming to establish minimum and maximum price ceilings or exact pricing, the determination of the minimum wage, the administration of public property, the granting of aids and subsidies. The role of these measures is to ensure principles of equality, well-being and the establishment of a decent living standard. Regarding the state intervention at a macroeconomic level, it shall be said that the measures to be taken are regulations which aim to remove or prevent imbalances that affect unemployment and inflation. These regulations are called fiscal-budgetary policies. For example, the allocation of financial resources through the budget setup law is an effective leverage to influence the economic and financial activity and social life. We take into account that the allocation of public financial resources implies not only their adjustment from the budget to the authorizing officers to be used according to the approved destinations. They also end in the transfers of funds between the public budgets, as well as between the budget credit coordinators, which may lead to a differentiated financing of the economic sectors (the administrative-territorial units, the public institutions) in accordance with the state's interest at a given moment. In the case of a rising unemployment rate, in order to ensure sustainable growth (sustainable in terms of job creation, sectors such as production that offer higher wages while keeping the jobs on the long-term, to the detriment of jobs in the services sector, where the jobs are considered to be short term and the wages are lower) of the jobs offered, fiscal policies that are being implemented have to encourage investments, as well as redistribution of resources collected to the state budget to ensure the increase in the domestic consumption. Increasing consumption leads to economic growth, but if the fiscal and budgetary policies stimulate external consumption by augmenting the number of imports and moving the trade balance on a deficient trend, the consumer will pay wages in the countries where the products are imported from. This situation can be prevented by policies that stimulate internal consumption, investments in industry, measures that increase the number of local or regional jobs.

6. The emergence of budget deficits and public debt

The financial crisis and fiscal policies applied in Europe for decades played a decisive role in the growth of public debt. Firstly, the financial crisis contributed to the explosion of budget deficits and the significant increase in public debt. The financial crisis played an important role in raising public debt, but its origins dates earlier. The increase of public debt is linked, on the one hand, to a decrease in state budgetary revenues and tax benefits offered to businesses and individuals, starting around a quarter of a century ago. All the governments of the world, whatever their political colour, put this into practice. These measures, promoted on a European scale to stimulate labour supply and improve the competitiveness of companies, not only contributed to a considerable increase in social inequalities but also exhausted public finances. The Greek and Irish examples are rich in lessons. They show that the debt crisis that hit Europe is a legacy of monetary and fiscal policies going on for decades on the European continent.

An economy goes into recession when it records the decline in GDP two consecutive semesters. Throughout the world, the financial needs of the state prove to be permanent. These are covered through the revenue received by the state under the right to perceive taxes, duties and other contributions. Taxes are perceived from the contributing capacity of the population, on the principle of equivalence. State revenues and the opportunities to procure them are almost never sufficient to cover all their spending over the period considered (usually one year). This lack of resources leads to budget deficits. Deficit coverage is achieved by recourse to internal or external borrowing. The cumulative sums borrowed and remaining to be repaid leads to what is called public debt.

The evolution of public debt - generated by the mismanagement of public funds or by the creditors themselves - was marked by stages that sometimes proved to be real consequences for the debtor countries. The large amount of public debt generated by the EU Member States increased significantly in the past fifteen years, and there are questions about the state of health of public finances and the European sustainability of fiscal and budgetary policy. Most countries face the need to rethink the policy makers approach, adopt a prudent policy in which public debt should be at a sustainable level, and the debt portfolio should be suited to the particularities of each state. Another important debt issue is that future generations will have to bear the burden of reimbursing them, which will generate low employment rates and lead to the aging of the population. The accelerated rise in public debt in euro area countries has shown the possibility of a rapid deterioration in the public finances position in the context of an economic downturn, a significant increase in financing costs for countries deemed to be unsafe and with large deficits, due to lower budget revenues compared to budget expenditures. In theory, it is considered that a reasonable level of public debt may play a positive role in the economic growth. Thus, investment projects that exceed the resources available at one time can be funded, poor countries can be supported with faster growth, and the state can play a role in stabilizing the economy in case of imbalances. However, public debt has a negative effect on economic growth, because heavily indebted states can be exposed to the risk of capital outflows or the rapid deterioration of public finances in the context of an economic and financial crisis.

A country's total debt integrates public debt and private debt. In turn, these two components can be broken down by source of funds into: internal debt and external debt. The need for additional resources of a state, reflected in the contracting of public loans, has two major factors: the consolidated budget deficit at the end of each year and repayment of loans contracted by the state. A characteristic feature of the economies in transition - a situation typical of Romania - is that, in addition to the above causes, there also exists a third factor which is very important in terms of size and size, namely:

- State takeover of non-performing assets from state-owned enterprises.

All countries looking for rapid economic and social development require credit and the ability to negotiate advantageous terms. Although these loans solve a series of economic problems such as unemployment, rising living standards, they overburden the tax burden of future generations, as loans over 25-30 and even 40 years cannot be reimbursed by a single generation.

7. The objectives and impact of fiscal policies

The fiscal policies can be defined as a set of methods, means and tools to mobilize, allocate and use the financial resources needed to achieve the economic objectives in a given period. Fiscal policy also includes regulations and institutions through which public financial resources are managed. Fiscal policies can have effects at both microeconomic and macroeconomic levels.

One of the most debated economic issues in the last period is how fiscal policy affects the macroeconomic indicators. Macroeconomic indicators reflect the state of the economy of a country. The impact of fiscal policy - and hence of public debt - on economic growth and other economic variables was always the subject of debate among economists. The topicality of this issue, corroborated with the implications that financial policies have on the macroeconomic stability and economic development of a country, are matters that justify the interest in this field.

Fiscal policies play an important role in the economic growth and welfare of society, aiming at reducing fluctuations and economic instability, protecting consumer incomes and stimulating development. They are a factor of particular importance in economic life, and their influence and effects on the functioning of the economy must be analysed in detail. As public finances form a field of research that addresses public revenue and expenditure issues in particular, fiscal policies need to be analysed in light of macroeconomic imbalances and lack of economic stability that Europe faced in recent years.

Fiscal policies, depending on their goals, may be procyclical or countercyclical. Before defining them, it is necessary to understand the economic cycle. It consists of fluctuations in the economy, which occur abruptly over a period of time. Thus, the economy is characterized by a form of cyclicality. Economic cyclicality is characterized by the fluctuation of economic activity in a country, so there are periods in which the economy contracts or when it has an expansive character. An economic cycle is made up of two economic phases: expansion and recession.

The economic expansion phase is characterized by increased demand and, implicitly, production, increased national income, employment and wages. Companies have easier access to credit, leading to higher investment but also to costs that do not add value to the final product or service. In the recession phase, supply is much higher than demand. Companies are looking to reduce their costs, often resulting in layoffs that lead to higher unemployment. Consumption is decreasing, access to credit is getting harder, real estate assets are rapidly losing value, investments declines. In the recession phase, the state is experiencing substantial revenue cuts and increases in spending (especially social), as opposed to the economic expansion in which the state registers revenue growth.

Procyclical policies are aimed at boosting economic growth during the economic expansion phase. Reactions of companies following the implementation of these policies lead to wage increases, easy lending to individuals and businesses, and often to unsustainable investments. Applying such policies is wrong, because when the state of the economy comes down, the state faces a lack of fiscal space. Thus, the room for manoeuvre for fiscal relaxation during the recession is exhausted, the economy deepens in recession. Following the recession, due to lack of fiscal space, the economy cannot be stimulated, so pro-cyclical policy is pursued through measures meant to renounce investment, lower incomes of the population, increase tax.

Anti-cyclical policies are measures that counter the economic cycle. These measures applied during economic expansion have the role of moderating economic growth: when the economy decreases, there is a fiscal space to increase investment and lower tax rates. These measures are related to raising interest rates, that is to increase taxation. Implementing anticyclical policies must be the basic rule of the state, characterized by a reduction in public spending and budget deficits in times of expansion, and rising spending in the shrinking phases of the economy.

The emergence of the financial crisis and the way fiscal policies were implemented in Europe for decades played a decisive role in raising unsustainable public debt and excessive budget deficits. After the economic crisis started in 2007, tax authorities and researchers focused their attention on fiscal policy, which as a monetary policy should be controlled and labelled as a responsible rule (Leeper, 2010; Daniel and Shiamptanis, 2013). In order for the fiscal policy to be a responsible policy, it must be sustainable. In addition, the proper use of fiscal policy instruments depend on the specificities and needs of the economy, as well as on the economic cycle. Finding an optimal policy remains a challenge for both tax authorities and researchers around the world. Between 2007 and 2010 many countries were unprepared to cope with the economic crisis, suffered excessive deficits and unsustainable debt due to the application of procyclical fiscal policies. The last period has shown increased prudence in setting fiscal-budgetary policies. Specialists show that developing countries and emerging countries typically use a pro-cyclical policy, and the developed countries usually use an anticyclical policy.

In the last 12 years, the economy trend rose, was followed by recession, and economic growth resumed in recent years. Lately, against the backdrop of the unhealthy growth of the economy over the 2004-2008 period, great importance was added to the applied fiscal policies.

The importance and necessity of research bears in mind that many countries acted imprudently in the period when the economy expanded, accumulating deficits and debts. Robert Barro (1979) demonstrates that the public debt burden will sooner or later be transferred to the fiscal area, leading to increased tax and reduction of the production potential. He says it is necessary to raise taxes to support public debt service. This decision will negatively affect the potential GDP. Barro argues that there is also the alternative of decreasing government spending, but that would also have a contraction effect on production. The maturity structure of public debt is also important because, as noted, there is an obvious link between the inflation and the real cost of debt, as long-term government debt is extremely vulnerable to inflation. At present, European public financial policies are focused on prudence, not on excessive deficits.

8. Tools and techniques used to finance budgetary deficits

The budgetary deficits formed on the budgetary expenditures are bigger than revenues collected in a budgetary year. Budgetary construction is based on the forecast of the main macroeconomic indicators and on the economic and social measures to be implemented, having an impact on budget revenues and expenditures. Budgetary projections mostly allow the accumulation of deficits. These budgetary deficits are designed to provide the necessary space for investment, fiscal relaxation or wage growth.

Maintaining an unsustainable budget deficit may have a negative effect on economic growth, given the vulnerabilities of the international economic environment. It is also very important how money is spent when registering a budget deficit. If these amounts are not "thrown" into the economy in the form of expenditures that generate economic growth, with non-revenue-generating expenditures maintaining the budget deficit proves to be unsustainable. Depending on the pattern, the deficit may be caused by a crisis if the state cannot cover its budget expenditure due to a low level of revenue collection, or to a development deficit in the case that the volume of investments is high.

As a budgetary deficit can be considered a good policy, it must be reflected in investment expenditure. Given the medium and long-term effect of investing in the economy, it is imperative to observe a very important rule of public finances, namely that the volume of investments must be higher than the level of the budget deficit.

The recording of unsustainable budget deficits leads to an increase in public debt. It is also preferable for the budgetary deficit to be covered by secure financial resources, avoiding contracting large-interest rate loans and printing money to avoid inflation. Of course, the possibility of contracting low interest loans depends on the state of the country's economy, in the sense that if there is a risk, potential lenders will offer loans at high interest rates. If the trend of the state economy is predictable and fiscal policies are sustainable, lenders will offer low-interest rate loans due to increased confidence.

Lloyd et al. (1982) highlighted the fiscal responsibility of governments, explaining that if the annual budget is built around the existence of a budget deficit, this action is not an act of irresponsibility. However, the fiscal responsibility of the government comes from the implementation of fiscal policies designed to make full use of resources, a noninflationary level of income and production.

If the budgetary expenditures cover current revenues, the state has a choice between raising the level of taxation and borrowing. Recent history showed that most countries opted to borrow money because tax increase policies affects people's welfare, resulting in political consequences. Moreover, borrowed financial resources are collected quicker than tax collections. Of course, these advantages lie just on the surface. Decisions of this kind led to the accumulation of public debt values which are very difficult to repay and refinance. It is not only that borrowing money is a means of collecting money which is more expensive than rising taxes, but as public debt increases and economic stability decreases, these loans are becoming more and more difficult to borrow (the lender offers high interest rates due to mistrust in the country's possibility of paying them). Also, the purpose of these loans is unproductive, and no added value is generated.

Sources of budgetary deficits financing can be internal or external. It is preferable that financing the deficit should be made from internal sources such as: issuing of treasury bills or government securities, privatization of state-owned companies, capitalization of state assets. As far as the external financing sources are concerned, they come from external loans, external financing, and issuance of government securities on the foreign banking market.

A rule of fiscal-budgetary responsibility is that these inputs of financial resources, both internal and external, should be involved in non-recurrent expenditures.

9. Conclusions

The emergence and evolution of public finances is closely related to the consolidation of the state. Public finances are social relationships of an economic nature that arise in the process of gross domestic product production and distribution.

Within the European Commission some priorities are highlighted, including fiscal responsibility. Excessive public debt is a source of instability and a hindrance to Europe's growth and development. A key objective is the balanced structural budget in all Member States, which is expressed in terms of planned budgetary difficulties. Most EU Member States have a medium-term objective of 0.5% structural budget deficit in GDP. It is also necessary to reduce public debt in the case of Member States with a particularly heavy debt burden.

Building a budget with a low deficit can have positive effects on the economy as it stimulates demand and investment, actions that increase budgetary revenues. If the budgetary deficit is high and is manifested over a long period of time, it leads to negative effects on the economy, exacerbating imbalances such as inflation and unemployment.

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