

THE INFLUENCE OF THE FISCAL POLICY AND THE AUTOMATIC STABILIZERS ON THE ECONOMY

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Abstract:

The current economical and financial crisis has a powerful effect on the public finances, as in the reduction of the economical activity lead to the reduction of the budgetary income, increase of deficits and of public debt. Furthermore, the support given to the banks having problems in the main industrialized counties, materialized in pumping liquidities into the system but also the taking over of uncertain assets will be finally reflected also on the public debt.

The anti-cyclic policies consist of an assembly of macro-economical measurements that want either the increase of the aggregated demand or the encouraging of the global offer. In this paper, a synthesis was attempted of the conceptual approaches, in terms of defining the automated stabilizers, a synthesis including both the classic/traditional approaches and the current ones.

Currently, the mix of anti-cyclic policies, of which these automatic fiscal stabilizers are part of, moved from the use with predilection of these towards fiscal simulation programs of a large scale. Secondary effects of these policies and of the fiscal stabilizers will be materialized in a never seen increase of the public debt, and in difficulties of covering the retirement expenditure given the global aging of the population in the developed countries.

In order to reduce the effects of the current crisis, the state calls for fiscal stimulation measurements, those being a combination of public expenses and tax reduction for companies that want to recover the economical activity, the increase of the work places' occupation degree and the caring of the business environment.

Keywords: Automatic Stabilizers, Anti-cyclic Policies, Fiscal stabilizers, Stabilization Policies;

JEL Classification: G30, G28, G32, G01;

INTRODUCTION

The anti-cyclic policies were developed based on "a better knowledge of the economy's interdependencies and the increase of the economical evolution's informing capacity", and consist of an assembly of macro-economical measurements taken in order to minimize the impact on the economical re-launch in the descendent phases of the economical phases, or adjusting the amplitude of the perturbing cyclic phenomena. In general, the mix of anti-cyclic policies wants both the influence of the global demand and of the aggregated offer, and the movement of these policies' weight center takes into consideration a series of aspects belonging to the economical cycle's phases, the phenomena and economical processes' knowledge degree or the ability of the political factor to impose certain solutions.

THE FISCAL ANTY-CYCLIC POLICIES

The anti-cyclic policies based on influencing the global demand start from the Keynesian conception according to which the economical activity flows are due first of all to the unwanted gap between the global demand and aggregated offer.

The fiscal policy may contribute to the modification of the accessible income, as it was in the case of the unique taxation rate application in Romania starting with 2005. The curve of the regular demand of a certain good is deduced under certain hypotheses concerning the society members' income, and must be deduced again if the income modifies.

The increase of the income available to the population and economical agents contributed to the making of an increased economical growth rhythm from 2005 to 2008, but in the same

time in the absence of real increase measurements of the aggregated offer contributed to the increase of the current account deficit by a never seen increase of imports.

The fiscal policy may act in the economical conjuncture by modifying the taxation degree in order to stop or stimulate investments and production. Therefore, in periods of economical welfare, an increase of taxation leads to the reduction of available income, having as main effect the reduction of the economical growth rhythm, while in times of recession a reduction of taxation makes the available income grow and based on this a stimulation of the global demand is mare.

The public expenditure may act as well on the global demand by state acquisitions, infrastructure investments, social assistance etc. Therefore, in the recession stage, the budgetary expenses are increased with the risk of assuming a budgetary deficit that can be absorbed in its expansion phase, with the reduction of budgetary expense.

The anti-cyclic policies based on the stimulation of the aggregated offer wish to stimulate the producers by offering material and fiscal advantages, subvention giving with impact on the volume, structure and quality of merchandise and offered services.

FISCAL STABILIZERS

What are automatic stabilizers? Automatic stabilizers are taxes and transfers such as unemployment compensation and food stamps that automatically change with changes in economic conditions in a way that dampens economic cycles. For example, when the economy turns downward, the amount spent on food stamps automatically goes up as more people apply or eligibility rules are eased. The extra spending the food stamps generates helps to soften the downturn for the individuals receiving the help, and also benefits the businesses and employees where the money is spent (and the multiplier process spreads the benefits more widely). Similarly, unemployment compensation, which obviously rises as jobs are eliminated, goes up when conditions deteriorate and this also provides a boost to demand.

The traditional concept of the economical automatism, derived from the liberal conception is not far away from Adam Smith's invisible hands principle, when using the fiscal policy as an economical stabilization technique. The observation is valid because in the economical prosperity periods, the collection of taxes increases, while in times of recession, with the decreasing of income and consume also the state budget collections decrease, especially when applying the proportional percentage rate taxation, as in the case of our country's unique rate.

The governmental expenses also have a stabilizing influence on the economy, especially when established as GDP ratios for certain domains. Therefore, it may be said that with the economical development, the economists tried to find solutions to control or modify the economical cycle, therefore the concept of "automatic stabilizers" being developed. N.F. Keiser (1956) made an analysis of this concept in order to find its origins. He made an inventory of all the criteria by which an automatic stabilizer can be identified, as presented in the specialty literature by that time. So, W.P. Egle (1952) stipulates the following criteria for an automatic stabilizer:

- It is permanently installed;
- Is endowed with very well defined purposes and stipulations;
- Is tightly connected to the indices sensible to the economical cycle, that is - the mechanism stats to act anti-cyclically as soon as this index shows the need for action.
- According to Albert Hart, the automatic stabilizers are recognized by the following criteria:
- They lead the budget towards exceeding in the growth stage of the economical cycle and towards deficit in case of recession;
- They minimize the cash stock of the population in periods of prosperity and increases it in case of recession;

- They tend to increase the population's demand for cash in periods of prosperity and reduces it in periods of decline;
- They act without waiting for the deciders' actions.

The stabilization policies are of many types, according to N.F. Keiser, and the automatic stabilizers represent only one of these stabilization policies that include:

- The automatic stabilizers (such as social insurance payments, income and profit taxes) incorporated in the economy, operating in present and tending to increase the income in case of decline and diminish it in case of economical boom;
- Flexible formula stabilizers (such as an automated modification of the taxation rate) acting at the apparition of a danger signal (such as unemployment);
- Discretionary stabilization policies (such as the control of the central bank loan) endowing with power agents, councils, persons;
- Institutional stabilizers (such as the Central Bank, syndicates, review of the fiscal structure etc), tending to strengthen the economy.

It is difficult to design a person to which the automatic stabilizer concept was attributed, but in the specialty literature four bibliographical sources are quoted when talking of this concept:

- The US Economical Development Committee;
- Friedman (1948);
- Hart (1953)
- Musgrave and Miller (1948).

The general concept of economical automatism was generally associated to the market forces in which the factors of the perfect competition govern the production, distribution and goods exchange at levels that approximate the complete use of the available resources. Although this concept is far from the modern meaning of the automatic stabilizer, there are similarities between them, that is- they both exclude the discretionary administrative or legislative intervention.

Another important moment in developing the automatic stabilizer concept was, according to N.F. Keiser (1956) the development of the fiscal policy as a stabilization technique, the use of the imbalanced budget to reach full occupation and, therefore, the use of automatic stabilizers as an auxiliary method.

The emphasizing of the fiscal policy's role as an anti-cyclic mechanism was made in the 30s, the credits being given to J.M Keynes and its attack on the classic principles of public finances' balance and total occupation. J. Tam and H. Kirkham (2001) explain that the budgetary sale includes a structural component (which does not modify with the economical cycle) and a cyclic component:

$$\text{Budgetary sale} = \text{structural component} + \text{cyclic component}$$

The action of the automatic fiscal stabilizers involves the fact that the government is to maintain the taxation rates constant during an economical cycle. The alternative is to modify the taxation rates every year, so to maintain constant the value of taxes and expenses and insure a balance of the economical cycle every year.

The automated fiscal stabilizers represent the variation of the budgetary sale as result of an exogenous shock on the GDP. For example, such an exogenous cyclic shock, such as restraining demand in the public sector will tend to reduce the fiscal income, and in the same time it will generate an increase of expenditure with unemployment payments. The automatic increase of the public expense will help to the minimization of the shock's effects adversely initial on the aggregated demand. The stronger the automatic stabilizer's effects, the less necessity for legislative discretionary action during the economical cycle.

J. Tam and H. Kirkham (2001) state that there is a wide point of view spread, referring to the fact that these stabilizer act quicker than other stabilization instruments. Therefore, the automatic fiscal stabilizers do not involve interior lags, usually seen at the discretionary

modifications of fiscal policy. In addition, they involve exterior lags that are smaller than in the case of monetary policies.

Numerous studies tried to demonstrate the effects of the automated fiscal stabilizers. So, T.J. Kneiser and J.P. Ziliak (2002) studied the effects of the fiscal reforms in the 80s USA, on the automated stabilization of the consume. Their conclusion was that the progressive rate income tax system introduced in the US in the 80s stabilized the consume with circa 15% in the case of asymmetric shocks on income. In some cases, the automatic stabilization effect was even increased, inherent to a progressive rate taxation system.

Cohen and Follette (2000), using a model of the Federal Reserve Bank, suggest that the automated fiscal stabilizers cushion the imperfections on the demand, but cannot compensate for the shocks on the offer.

Christiano and Harrison (1999) made a simulation model of a real economical cycle, by which they showed that the benefits of the automated stabilizers in the fiscal system exist especially due to their effects of reducing the GDP's volatility. Romer (1999) stated that the automated fiscal stabilizers contribute with 0.85% to the GDP increasing rate.

P.H. Pearse (1962) analyzes the impact of the automated fiscal stabilizers in the case of the British economy. He concludes that the stabilizing effect is bigger as the flexibility of the fiscal effectiveness increases, the marginal inclining towards the consume increases and the part on income flows attributable to the undistributed profits is smaller.

The current economical and financial crisis, by its virulence, cancelled greatly the capacity of the automatic stabilizers to answer to it, as they did in the last 50 years for the flows affecting the world economy, reason for which the most affected states moved on to wide fiscal stimulation programs.

The fiscal stimulation is a combination of public expenses and tax reduction for companies that want to recover the economical activity, the increase of the work places' occupation degree and the caring of the business environment. The government/state's intervention in the economy must be taken into consideration, which can be made deliberatively or discretionary, with effects that are not always good.

The Stability and Growth Pact assures the corresponding principles for the fiscal policy behavior in the euro zone. These principles specify mostly the mode of adjusting the structural budgetary sale towards reaching a mid-term objective consisting in "a surplus or almost zero position", whose level is specific to each country. These mid-term objectives were set at a level that insures the fiscal sustainability, and a sufficient maneuver margin to avoid the overpass of the 3%GDP level, given the normal economical flows. Indeed, the countries that reached their mid-term objectives are free to allow the automatic stabilizers to work and therefore contribute to the diminishing of the economical cycle. The more countries in the euro zone are in this position, the more action liberty will be for the automated stabilizers at the level aggregated by the zone contributing at the well functioning of the EMU.

The advantages of the automatic stabilizers' functioning are known. Unlike the discretionary measurements, these are not affected by the temporary gaps of the decisional process. However, their action is not determined by the political factor, and their economical impact is automatically adjusted with the economical cycle. Furthermore, the experience of the previous decades recommends a prudent behavior.

The recent experience sustains the advantage of automatic stabilizers, but indicates in the same time that the budgetary expenses superior to 40% GDP do not generate additional benefits in terms of stability. The functioning of the automatic stabilizers on the expenses part can be misinterpreted as argument to overcome the public expenditure limits, situation that can be tough to reverse. Nonetheless, there is the significant uncertainty referring to the GDP deviation measurement from its potential level and, as such, the measure in which the automatic stabilizers already affect the economy.

The "euro zone" countries with significant budgetary deficits and public debt increased percentages must put the accent on respecting the consolidation requirements, stipulated in the

Growth and Stability pact, in order to reach its mid-term objectives. The reach of these objectives will allow the free and complete functioning of the automatic stabilizers in the given countries, therefore contributing to the minimization of the economical cycle flows. So, those countries must resist to the temptation of calling for the fiscal policy and the fine-tuning of the short-term economy, because these might negatively affect the economical growth potential on long-term and the fiscal sustainability.

Therefore, the "euro zone" countries should take into consideration the previous years' lessons and promote prudent and solid fiscal policies of a consistent manner. Nonetheless, a discretionary fiscal stimulus may also generate inflationist pressures. In the current context when the euro zone inflation is at high levels, the additional stimuli on behalf of the fiscal policy will continue to amplify the risk at the price stability address. Even the small fiscal stimuli may have negative, durable effects, in the case when these contribute to the increase of the inflationist anticipations.

CONCLUSIONS

The explicit, or deliberate intervention of the state/government in the macro-economical adjustment is known as discretionary policy, while the implicit, non-deliberate intervention sends to the concept of automated stabilizers. Reasons of cost, efficacy or institution seem to recommend the use of implicit macro-stability policies, that is- the projecting and implementation of automatic (fiscal) stabilizers. Technically, these represent automatic procedures of negative feedback. If the economical philosophy of a state can lead to a small degree of public intervention by explicit regulation, than the economical dynamics may be very well managed by an implicit regulation, that is- by the automatic stabilizers. Of the fundamental virtues of these stabilizers, we recall:

- the anti-cyclic character, assuring the negative feedback of the adjustment;
- the oversized character, assuring the adjustment's efficacy;
- the structural character, assuring the adjustment's persistence.

Therefore, one of the lessons of the current economical and financial crisis can be to reduce the discretionary character of the economical adjustment policies and introduction, financially and fiscally, of the fiscal automatic stabilizers. In the developing countries, there still exists the concept that a relaxed fiscal policy, with high budgetary deficits, is needed to assure the economical growth. But, the specialty literature shows, without any doubt, that the discretionary fiscal policies increase the volatility and uncertainty of the future GDP evolution, and on higher inflation rates - of over 8%, the fiscal policy increases the unpredictability of the inflation's evolution, especially in those countries where the monetary policy is subordinated *de facto*.

The fiscal policy promoted in Romania should take into consideration the increase of the public finances' stabilizing role, especially in maintaining a descendent trajectory of the inflation rate and the current account deficit within sustainable limits.

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