FISCAL POLICY AND THE NEED OF ITS COORDINATION WITH THE MONETARY POLICY IN THE CURRENT ECONOMIC CRISIS

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Abstract: The aim of this article is to present the role of fiscal and monetary policy and the way they affect economies of the countries facing a crisis, as well as their ability to contribute to the sustainable economic growth. We will focus on the countries of the European Union and the Romanian economy and will highlight the need to correlate fiscal and monetary issues in order to achieve a fiscal and monetary convergence at the level of the European Union. We will find that the interdependence string of these policies mainly starts from the tax systems structure, by means of which the annual union budget funds are mostly achieved, which, in turn, is the funding source of the monetary policy implementation. We will also observe the need for a correlation between monetary and fiscal issues in order to achieve an efficient and sustainable economic activity in the European Union.

Keywords: Fiscal policy, economic crisis, monetary policy, Euro area, tariffs and taxes.

1. Introduction

The current economic crisis has led to numerous macroeconomic imbalances both domestically and internationally. Although it was initially located in the US economy, it rapidly extended to the global economy, affecting both developed and emerging economies. The fundamental causes of the crisis are deep, both macroeconomic and microeconomic in nature, idea stated by many analysts: Altman (2009), Buiter (2008), Blanchard (2009). The two types of cases have interconditioned in the production of the crisis and among the effects with a major economic impact on the economy such as inflation and unemployment.

The problem of monetary and fiscal policy interactions is an important issue for the euro area, since the individual member states of the EMU are responsible for their fiscal policies but monetary policy is pursued by a single monetary authority, the ECB. The communitarian monetary policy has the purpose to ensure the financial stability of the European Union. Substantial progress has been made within the process of monetary integration, especially through the creation and strengthening of the euro area and its specific management mechanisms. However, a number of limitations on the institutional framework and instruments of monetary policy show their dependence on the fiscal and budgetary policies of the European Union. Therefore, the general tendency is to advance fiscal and monetary coordination and convergence at EU level.

A deep analysis of the fiscal policy also requires coverage of aspects related to monetary policy because monetary policy’s effectiveness is determined by the effectiveness of fiscal coordination. The series of these policies’ interdependence mainly starts from the tax systems structure, by means of which the annual union budget funds are mostly achieved which, in turn, is the funding source of the monetary policy implementation. Nowadays, it is becoming increasingly obvious the need to correlate monetary and fiscal aspects for the sustainability and efficiency of economic activity in the European Union.

2. Literature review

A large literature focused on the interaction between monetary and fiscal policy in stabilizing the economy, considering that in our time, the efficiency of monetary policy and the automatic fiscal stabilizers may be insufficient and, in those circumstances, the fiscal policy must be in the first line and the policymakers need to use fiscal stimulus to help the economy.

The two major instruments to maintain macroeconomic balance is a subject of dispute between Keynesians and the monetarist theorists (Keynes, 1936, Friedman & Schwartz, 1963; Williamson & Wright, 2010). For the Keynesian doctrine the fiscal policy influences the global demand much more consistently than the monetary policy (Keynes, 1936). For this reason, monetary instruments are entrusted generally with ancillary roles, to support the tax ones. Monetarist economists present however some disadvantages of fiscal policy, considering the monetary policy as the main macroeconomic instrument. They bring arguments for some of the advantages of monetary policy as opposed to the fiscal policy: it is less subject to electoral considerations; changes in monetary policy could be made relatively quickly, while significant changes of taxes or public expenditures require the approval of the legislature , their publication, issuing methodological norms and other formalities that last long enough; monetary policy instruments usually produce their effects in a shorter time than fiscal instruments (Friedman & Schwartz, 1963; Friedman 1968; Blinder, 1999; Way, 2000).

It is true that the emergence of a financial and economic crisis has a negative impact on the monetary and fiscal sector, but it is also true that appearance of the crisis was also favored by the lack of fiscal and monetary policy coordination. In this respect, Schuknecht et al. (2011) talk about an inefficient coordination of fiscal and monetary policies of the Member States.

For the decision-makers it is very important to know when fiscal policy measures become essential for the economy. There are some opinions (Elmendorf and Furman, 2008), which take into account major fiscal stimulus measures in addition to monetary policy where the monetary policy interest rate is close to zero, in case the decision-makers want a lower unemployment rate with a higher interest rate or when monetary policy is insufficient to stimulate the economy.

There also exists, a series of debates between the economists who are the advocates of government action as countercyclical fiscal policy (Romer and Bernstein, 2009, Elmendorf and Furman, 2008, Summers, Feldstein, 2008) and the others who believe that the fiscal policy must be limited in order to have its main countercyclical impact only throw the automatic stabilizers (Taylor 2002, 2009, Eichenbaum, 1997, Feldstein 2002, Cogan, Tobias, Taylor, Wieland, 2009, Wieland 2008, Kraay and Servén, 2008). Taking into consideration the traditional Keynesian framework, for the short-term objective, the fiscal policy is responsible for the stabilization of the business cycle. In the European countries, especially in the European Monetary Union (EMU), the fiscal policy has also an important role in short term stabilization efforts. Bernanke (cited by V Wieland, 2008), referring to the fiscal stimulus in US in 2008, considered that, "fiscal stimulus, if protracted, badly targeted and too late, it will not help support economic activity in the near term, and could be actively destabilizing if it comes at a time when growth is already improving".

Pelinescu and Caraiani (2010), referring to those aspects pointed by Sachs (2009) and Bernanke (2008) showed that they are very important for the efficiency of the fiscal stimulus and derive from the principle that must be taken into consideration when the policymakers decided to use fiscal stimulus to boost the economy. The economists' debate regarding the principles of fiscal and monetary policy revealed the importance of some criteria like transparency and credibility for the monetary policy and endorsed a series of principals for the fiscal policy: 1) timely, that means to use the fiscal stimulus at the right time, not prematurely, not too delayed, kipping in mind the time needed to implement some fiscal stimulus like tax cut or an increased spending; 2) targeted, which means that every money from fiscal stimulus will contribute to the maximum output raises in the short run; 3) temporary, which means that fiscal measure would be on the short run, and not affect the budget deficit in the long run. Heikensten (1999), for example, states that the efficiency of monetary policy might be affected by fiscal policy through its impact on demand and general confidence in monetary policy and by modifying the long-term conditions for economic growth with low inflation. On the other hand, monetary policy may be accommodative to fiscal policy or counteractive.

Considering fiscal policy as intervention tools for the European countries Krugman (2009) points that the coordination of the fiscal policy is even more important:" we're rapidly heading toward a world in which monetary policy has little or no traction: T-bill rates in the US are already zero, and near-zero rate will prevail in the euro zone quite soon. Fiscal policy is all that's left. But in Europe it's very hard to do a fiscal expansion unless it's coordinated"; and he continues to explain why, in his opinion the coordination is very important for Europe: "The reason is that the European economy is so integrated: European countries spend around a quarter of their GDP on imports from each other. Since imports tend to rise or fall faster than GDP during a business cycle, this probably means that about 40 percent of any change in final demand "leaks" across borders within Europe. As a result, the multiplier on fiscal policy within any given European country is much less than the multiplier on a coordinated fiscal expansion. And that in turn means that the tradeoff between deficits and supporting the economy in a time of trouble is much less favorable for any European country than for Europe as a whole".

Some researchers have tried to explore monetary and fiscal policy interactions from a strategic perspective. Examples include Catenaro (2000), van Aarle et al. (1995), Buti et al. (2000), Wyplosz (1999), and van Aarle et al.(2002). Van Aarle et al. (1995), for example, extend the analysis of Tabellini (1986) and reconsider the interactions between fiscal and monetary authorities in a differential game framework.

3. Aspects of fiscal and monetary policies in the European Union countries in the context of the current economic crisis

Whether it is used to cover administrative expenses or as economic mechanisms regulating funds, the EU budget is the foundation for implementing the community monetary policy. EU tax policy uses two types of collection tools, having as starting point their own nature: direct and indirect. The first category designates the taxation on income, wealth or profit, and indirect taxation is carried on consumption goods and services and appears in the following shapes: value added tax, excises, and rates. Between the two fundamental categories of taxes that contribute to the collection of public revenues, there are significant differences that determined the starting point of divergence on the fiscal tax communitarian harmonization.

The changes in the EU budget structure have occurred along with the increase of the degree of integration, the progress in this regard being obvious, as opposed to the '70s, when the establishment of a common fund was based on the contributions collected directly from national governments on grounds of proportionality, depending on the degree of economic development. Since 1980, the financing of the EU budget is done integrally, according the principle of the ' personal resources system", rightfully belonging to the Union, without the need for additional approvals and decisions of the national governments. The budget revenue collection is the prerogative of the Member States treasuries except the customs duties which by their nature rightfully belong to the communitarian budget. The Union's room for maneuver in the expansion of the budget revenues is limited by the European Council' decisions, reunited in Copenhagen, which sets a maximum level of 1.27 % of the Union budget from the Member States' cumulated GDP. The main sources of income are (Table 1).

Table 1. Revenues of the European Union budget in million of Euros

Types of Income	Budget 2012		Budget 2013	
Tariffs and taxes on sugar	16.824,20	12,4%	18.755,20	14,1%
Revenues from VAT	14.546,30	10,7%	15.029,95	11,3%
Income from PNB	97.284,22	71,7%	97.502,87	73,4%
Other Income	7.103,52	5,2%	1.548,97	1,2%
Total	135.758,24	100,0%	132.836,99	100,0%

On the whole, the fees are an important source of budget revenue for each of the Member States and the EU, but beyond the differences between types of fees, there are also large differences between collection performance differences of the Member States: among the most efficient countries in terms of tax collection in 2013 we can mention Belgium, Germany, France and Netherlands while Romania is found in the middle area of the rankings.

Table 2. Main fees as a source of budget revenue

	Tax on personal income			Tax on corporate income			VAT**		
	2000	2012	2013***	2000	2012	2013***	2000	2012	2013***
EU27*	44.8	38.1	38.7	31.9	23.0	23.0	19.2	21.0	21.3
Belgium	60.6	53.7	53.7	40.2	34.0	34.0	21.0	21.0	21.0
Bulgaria	40.0	10.0	10.0	32.5	10.0	10.0	20.0	20.0	20.0
Czech Republic	32.0	15.0	22.0	31.0	19.0	19.0	22.0	20.0	21.0
Denmark	62.9	55.4	55.6	32.0	25.0	25.0	25.0	25.0	25.0
Germany	53.8	47.5	47.5	51.6	29.8	29.8	16.0	19.0	19.0
Estonia	26.0	21.0	21.0	26.0	21.0	21.0	18.0	20.0	20.0
Ireland	44.0	41.0	41.0	24.0	12.5	12.5	21.0	23.0	23.0
Greece	45.0	49.0	46.0	40.0	20.0	26.0	18.0	23.0	23.0
Spain	48.0	52.0	52.0	35.0	30.0	30.0	16.0	18.0	21.0
France	59.0	46.8	50.2	37.8	36.1	36.1	19.6	19.6	19.6
Italy	45.9	47.3	43.0	41.3	31.4	27.5	20.0	21.0	22.0
Cyprus	40.0	38.5	38.5	29.0	10.0	10.0	10.0	17.0	18.0
Latvia	25.0	25.0	24.0	25.0	15.0	15.0	18.0	22.0	21.0
Lithuania	33.0	15.0	15.0	24.0	15.0	15.0	18.0	21.0	21.0
Luxembourg	47.2	41.3	43.6	37.5	28.8	29.2	15.0	15.0	15.0
Hungary	44.0	20.3	16.0	19.6	20.6	20.6	25.0	27.0	27.0
Malta	35.0	35.0	35.0	35.0	35.0	35.0	15.0	18.0	18.0
Netherlands	60.0	52.0	52.0	35.0	25.0	25.0	17.5	19.0	21.0
Austria	50.0	50.0	50.0	34.0	25.0	25.0	20.0	20.0	20.0
Poland	40.0	32.0	32.0	30.0	19.0	19.0	22.0	23.0	23.0
Portugal	40.0	49.0	53.0	35.2	31.5	31.5	17.0	23.0	23.0
Romania	40.0	16.0	16.0	25.0	16.0	16.0	19.0	24.0	24.0
Slovenia	50.0	41.0	50.0	25.0	18.0	17.0	19.0	20.0	20.0
Slovakia	42.0	19.0	25.0	29.0	19.0	23.0	23.0	20.0	20.0
Finland	54.0	49.0	51.1	29.0	24.5	24.5	22.0	23.0	24.0

Sweden	51.5	56.6	56.6	28.0	26.3	22.0	25.0	25.0	25.0
United Kingdom	40.0	50.0	45.0	30.0	24.0	23.0	17.5	20.0	20.0
Norway	47.5	40.0	40.0	28.0	28.0	28.0	:	:	:
Iceland	:	31.8	31.8	30.0	20.0	20.0	:	:	:

* Arithmetic average

** If two VAT rates were applicable during a year the one being in force for more than six months or introduced on 1 July is indicated in the table.

*** The cut-off date for taking into account changes in tax rates was 11 March 2013.

:Data not available

Source: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-29042013-CP/EN/2-29042013-CP-EN.PDF

The average top personal income tax rate 5 in the EU27 is 38.7% in 2013, up from 38.1% in 2012, but well below the level of 44.8% in 2000. The highest top rates on personal income in 2013 are observed in Sweden (56.6%), Denmark (55.6%), Belgium (53.7%), Portugal (53.0%), Spain and the Netherlands (both 52.0%), and the lowest in Bulgaria (10.0%), Lithuania (15.0%), Hungary and Romania (both 16.0%).

The income tax for natural and legal entities is, as it can be seen in Table 1, a significant source of contributions to the national budgets. It can be observed that in all EU Member States, income taxes represent a large percentage in the total amount of taxes collected in 2013. This automatically implies the significance of income tax for the Union budget, from which monetary policy instruments and funds of economic recovery are financed.

The average top corporate tax rate in the EU27 is 23.0% in 2013, stable compared with 2012, but well below its level in 2000. The highest statutory tax rates 6 on corporate income in 2013 are recorded in France (36.1%), Malta (35.0%) and Belgium (34.0%), and the lowest in Bulgaria and Cyprus (both 10.0%) and Ireland (12.5%).

Currently, the value-added tax within the European Union belongs to a complex legislation, formed particularly of directives. Closely related to the economic crisis and fluctuations in the financial markets, the VAT of various Member States has undergone several changes over the past few years, often upwards.

The average standard VAT rate 7 in the EU27 is 21.3% in 2013, slightly increased compared with 2012. In 2013 compared with 2012, six Member States increased their VAT rate, and only Latvia reduced it. In 2013, the standard VAT rate varies from 15.0% in Luxembourg and 18.0% in Cyprus and Malta to 27.0% in Hungary and 25.0% in Denmark and Sweden.

The alignment of the Union Member States to identical rates of the excises even after the establishment of the internal market was difficult to achieve, as it implied a unification of political interests, given the significant contribution of this type of taxes to the public income. However, the harmonization of the excise duty is imposed due to two main reasons: the discrepancies between the values of consumption taxes on the product set by national authorities increase the risk of cross-border tax evasion and the efforts to coordinate national policies on VAT requires closer cooperation in the field excise duty because they are calculated before collecting VAT.

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

- Mobilization 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.
- 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.
- 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.
- 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.
- Price stability: fiscal tools can be employed to contain inflationary and deflationary tendencies in the economy.

At the same time, the coordination between fiscal and monetary policy is an important objective in ensuring social welfare. For the central bank, it is very important to maintain the inflation targeting process, process that will also determine the government to lead a disciplined and coordinated fiscal policy.

During the evolution of European monetary policy, the need for the complementarity of a harmonized fiscal and monetary policy was highlighted. The two types of policies support and reinforce each other in the long term. Without this synergetic evolution, credibility and the very existence of EMU tend to be endangered as a consequence of the diversity of economic and fiscal systems of the Member States. Illustrative is the case of Great Britain and Denmark, which, although practice similar quotas for collecting the tax rates on profits, are vehemently opposed to a common tax rate, widespread in the EU. One of the main deductions of the Member States on tax harmonization is based on the comparative advantages that the differences in tax levels bring to some European manufacturers.

4. The present economic crisis and the Romanian fiscal consolidation

The Romanian economy as part of the European economy depends on the international economic context. When designing a tax reform, one should know the magnitude of the multiplier effect to reduce the tax rate, because it can lead to an excess aggregate demand, thereby determining inflationary effects difficult to stop, through high budget deficits in the medium and long term. Many economists argue that the measures of fiscal relaxation represent the essence of the economic approach through the aggregate supply. However, even if the tax decrease has an impact on aggregate demand and aggregate supply, effects are differentiated in size. The decrease in the incidence of taxation is much stronger on the aggregate demand and lower on the aggregate supply. In order to be effective and to reduce economic instability, fiscal policy should stimulate the economy during the recession and to restrict it during the inflation expansion. For the operation of fiscal policy, time is essential.

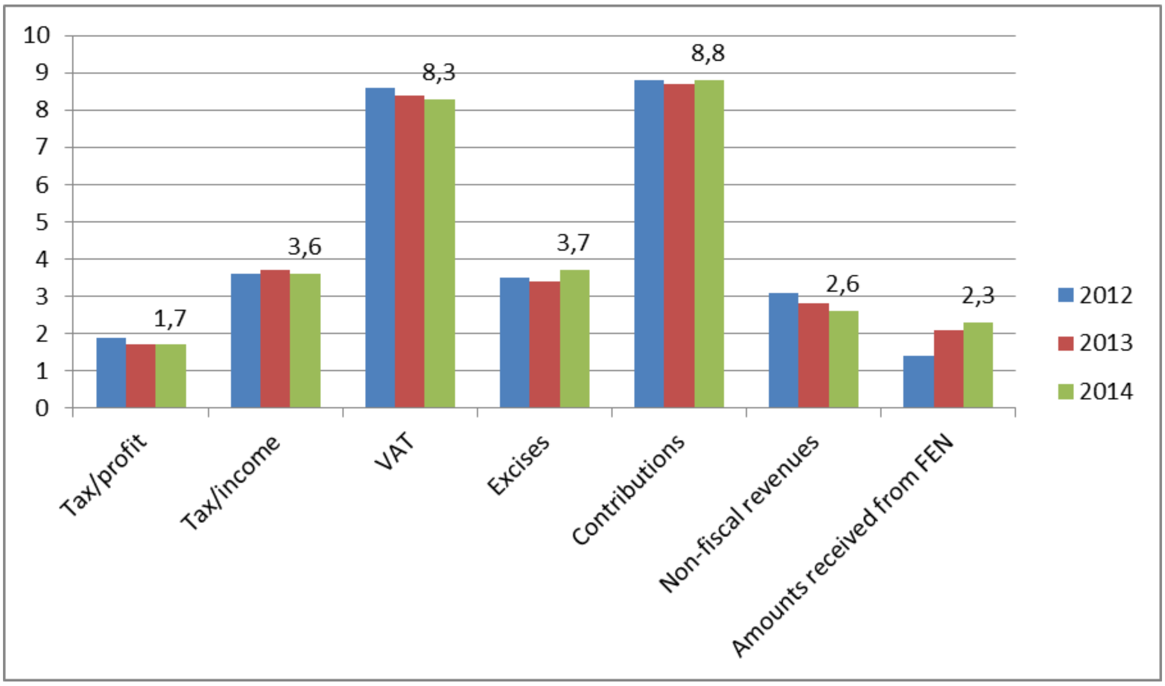
Referring to the impact that the fiscal and monetary measures have on the current Romanian economy one can observe that the Romanian economy is striving to overcome the prolonged economic crisis by increasing the exports. The two policies through which the state may influence the economy should react as follows: 1) on the one hand, monetary policy should decrease the credit cost to spur investment and this happens because the NRB lowered the monetary policy rate during 2013 from 5.25% to 4%, surpassing the initial expectations of analysts; 2) on the other hand, fiscal policy must respond to the desire to stimulate the economy, however, increase in public spending - required according to the theory to expand the aggregate demand - most times they are more than offset by increased taxation.

The fiscal policy and monetary policy have a significant influence on the economic and financial development of the country being considered macroeconomic harmonization instruments. In terms of a functioning market economy, financial and monetary instruments play an important role. They were designed in such way as to automatically generate some economic phenomena or just to trigger the decision makers. The action mechanism of the two instruments can be described by measures taken at the level of central bank and at the government level. Therefore, the central bank works through the commercial banks' increasing policy of the reserve requirements, which aims at reducing inflation while reducing money in circulation. By the fiscal policy the government affects the GDP growth. The state increases consumption, reduces taxes, the disposable income increases. Consumption growth, in its turn, increases internal demand for goods and services. Increased consumption demand stimulates producers to expand production and hire more workers. Unemployment will be reduced. The GDP will increase. Increasing market demand will lead to price increases. It will increase the demand for currency. As a result, the economy will face an inflationary effect. Therefore, the government's mission is to correctly combine these two policies in time.

In 2014, budget revenues of the Romanian economy are estimated at 216.8 billion lei representing 32.9% of GDP, that is, a percentage like in 2013. The estimation of the budget revenues will consider in 2014 reaching a level of 2.2% of budget deficit of GDP, forecasted based on the other macroeconomic indicators, the evolution of the macroeconomic framework, the need to increase the capacity to absorb EU funds. The largest weights in the budget revenues are recorded in contributions (8.8% of GDP), VAT (8.3% of GDP) and excises (3.7% of GDP).

Fig. 1. The evolution of the main revenues of the general budget in 2012-2014

Percent in GDP

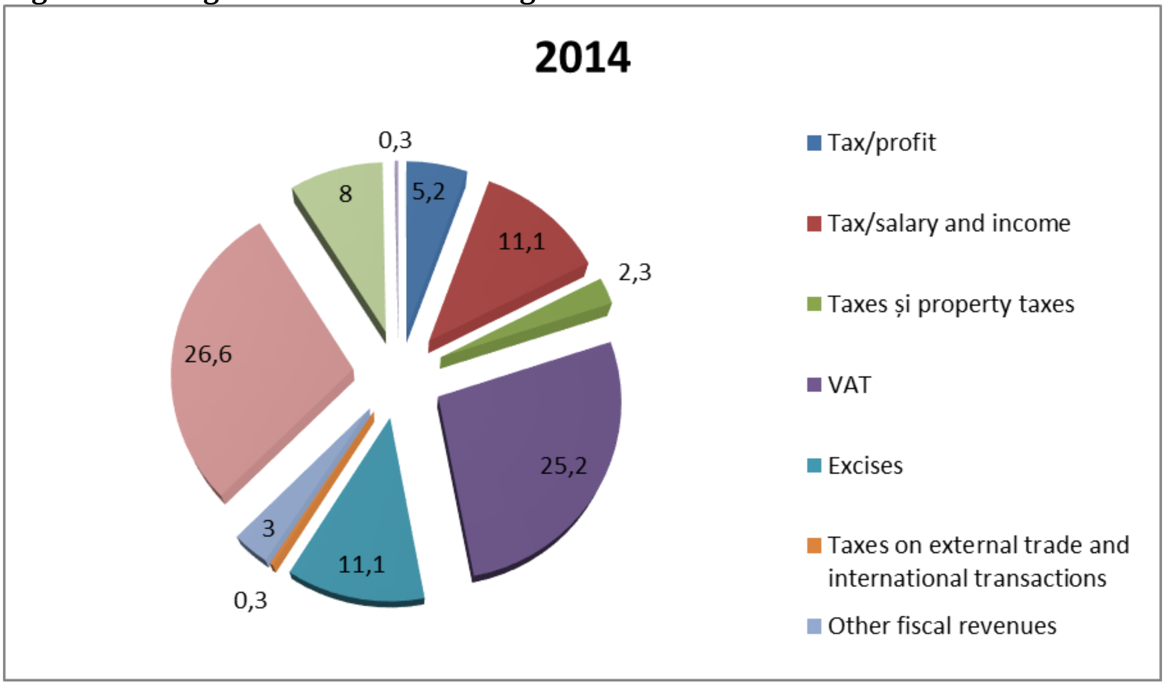


Source: MFP report regarding the macroeconomic situation for 2014 and its projection for 2015-2017

In Romania, the 2014 budget is a budget oriented towards the investments. The overall objective of the fiscal policy in 2014 is to continue reducing the budget deficit along with stimulating the economic growth increasing the public investment. Romania will continue to make a supported effort to enter public finances on a healthy path to restore the investors' confidence, to reduce the cost of the debt repayments and to create fiscal space for investments, since restoring fiscal sustainability will benefit both actors public and the private ones and will contribute to the overall stability of the country. Romania is considering a new vision of further fiscal consolidation to alleviate the impact on the economic growth, to equitably distribute the burden of adjustments, to remove disparities increasing the polarization of income and social tensions.

Regarding Romania's fiscal policy to the EU27 countries, there is found in the structure of collected budget revenues that tax and budget revenues are dependent on the incomes from indirect taxes and revenues (VAT, excise duties, custom duties etc.), while in the European Union, the contributions of the three major categories of taxes (direct, indirect taxes, and social contributions) to form the income are relatively close.

Fig. 2. The weight of total income budget revenue in 2014



Source: MFP report regarding the macroeconomic situation for 2014 and its projection for 2015-2017

Currently, Romania has one of the lowest tax rates in the EU27 for income individuals' tax. With a tax rate of 16%, Romania is situated between Bulgaria and the EU developed countries, where the progressive system is predominant. At the same time, the tax burden on labor, although it experienced a permanent reduction tendency, remains among the highest in the EU.

Regarding the tax on corporate profits, Romania has one of the lowest rates of the EU27 countries, but Bulgaria and Cyprus impose a tax on profit of only 10%. If we consider the combined tax rate (income tax + tax on dividends), we see that the EU developed countries have a more restrictive tax regime than Romania.

Lately, the national fiscal policy is oriented towards blurring the constraints on external support, to the development of a non-inflation process and the formation and strengthening of financial resources needed to achieve post-accession commitments assumed by Romania as a member state of the European Union.

In the conventional wisdom today is that monetary policy should be the main stabilization tool. Two major types of theoretical objections have been raised against using fiscal policy for stabilization purposes. The first one questions the technical effectiveness of such policies. The second objection questions the ability of policymakers to use fiscal stabilization policy in an effective way. There are number of arguments why discretionary fiscal policy may be used in a less effective way as a stabilization tool than monetary policy (Holt, 2009):

• Decision lags are longer, as tax and expenditure changes have to go through a lengthy parliamentary decision-making process, which is usually annual in contrast to the almost continuous decision-making process for monetary policy.

• The political character of fiscal policy decisions makes it much harder to reserve decisions when circumstances change than is the case for monetary policy.

• Fiscal policy has other central goals than stabilization, income distribution and resource allocation. In addition, fiscal policy measures are often influenced by attempts of incumbent governments to enhance their reelection chances, being a serious risk that the stabilization aspects will carry a low weight.

• The risk of an expansionary bias is much larger for fiscal policy than for monetary policy, as the former is run by policy-makers engaged in day-to-day politics, whereas the latter has been delegated to independent central banks, which can take a more long view.

The National Bank proved to be one of the institutions which maintained continuity in its actions to support the economy during the crisis and the only one that has taken actions to create a better macroeconomic situation at the national level, while the vision of the others authorities responsible for budgetary and fiscal policies cannot comprise a time-limit longer than 4 years.

5. Conclusions:

This paper is an analysis of the fiscal policy in the EU and Romania and highlights the need to correlate it with the monetary policy. The cooperation in terms of monetary and fiscal policy is essential in a globalized and unstable system. It assumes that both nationally and at an European level, the decision makers of monetary and fiscal institutions would work together with other oversight institutions to signal global risks and to adopt the same principles of macro-prudential policy.

Even if the two instruments don't always meet both the economic and social needs, there is no reason to neglect the use of these powerful tools that are in the hands of governments and central banks around the world. If used properly, fiscal and monetary policy can determine the direction of the economy of a country.

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