MONETARY AND FISCAL POST-CRISIS POLICIES IN ROMANIA

Mihaela Ifrim, Post PhD Fellow, SOP HRD/159/1.5/133675 Project, Romanian Academy, Iași Branch

Abstract: Monetary and fiscal tools available to policy makers often generate consequences opposite to expectations of their initiators. Mostly, tracking purposes in the short term attract adverse consequences in the medium and long term. We have in mind here mainly the cyclical evolution of the economy, the accelerated growth in the boom years, based on monetary expansion due to lax monetary policy, ending inevitably in an economic crisis followed by depression. Once produced, the economic contractions could be tempered by fiscal policy, but the reality refuses to follow economic logic. Monetary policy seeks the exit of depression using the same expansionary recipe that has generated it, while increasing social protection spending, growing public deficits and intensifying underground markets activities lead to increasing fiscal pressure, which only delay the resumption of growth. Monetary and fiscal policies post-crisis in Romania lack coordination. On the one hand, monetary policy aims to stimulate the consumption on credit, while fiscal policy by increasing taxes only inhibit it. The purpose of this paper is to analyze the duality of the fiscal and monetary measures in Romania, highlighting their effects on the real economy .

Keywords: monetary policy, fiscal policy, recession, credit, consumption.

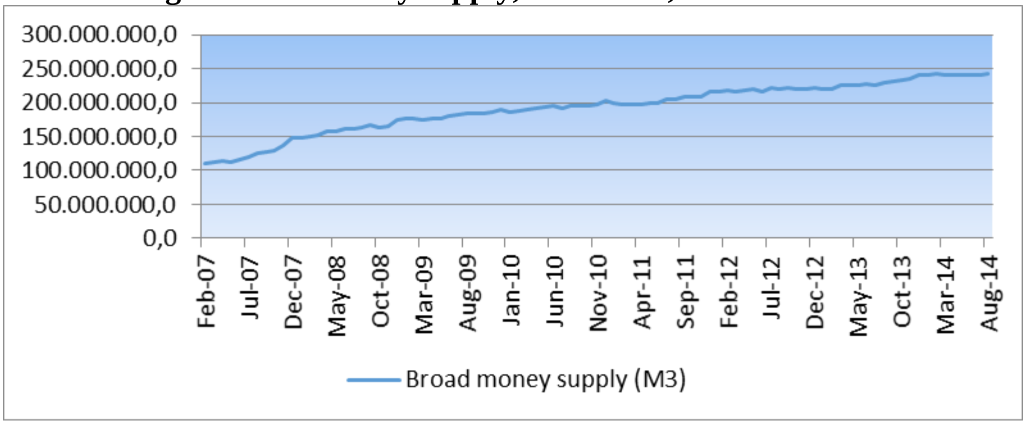
1. INTRODUCTION

The economic crisis was the natural consequence of expansionary monetary policies adopted by most countries in the world. The predictability of turning a boom into a burst has nothing to do with the claims of some economists to be able to predict the economic evolution, using sophisticated mathematical models, which lack in fact just the information to be introduced in their model. Dissipated knowledge in the minds of millions of participants in the market game is impossible to aggregate and shaped to generate economic forecasts, no matter how tempting they may be. It remains to emphasize the importance of correct understanding of economic phenomena and of the interdependencies between them in order to make value judgments on the effects of economic policies. In other words, economic qualitative judgments must regain their position along with quantitative estimates, assuming a higher degree of realism to the expansionary monetary policies adopted by most countries. This paper aims to make a critical analysis of monetary and fiscal policies in Romania, in the framework of current economic downturn. Designed to stimulate economic activity, these policies lead to opposite results both because of incorrect anticipation of their effects and because of the lack of coordination between their own mechanisms.

2. EXPANSIONARY MONETARY POLICY AND RESTRICTIVE FISCAL POLICY

The dominant feature of monetary policy in Romania is expansion. This can be seen both in terms of monetary growth as well as in gradual reduction of interest rates. The broad money supply increased from 109.614.957,4 thousand RON in February 2007, to 242.793.889,0 thousands RON in August 2014. This means an increase of 121% over a period of only seven years. Regarding the money in circulation, they rose from 14.163.344,6 thousand RON to 38.014.476,8 thousand RON, that is an increase by 2.7 times during the same period.

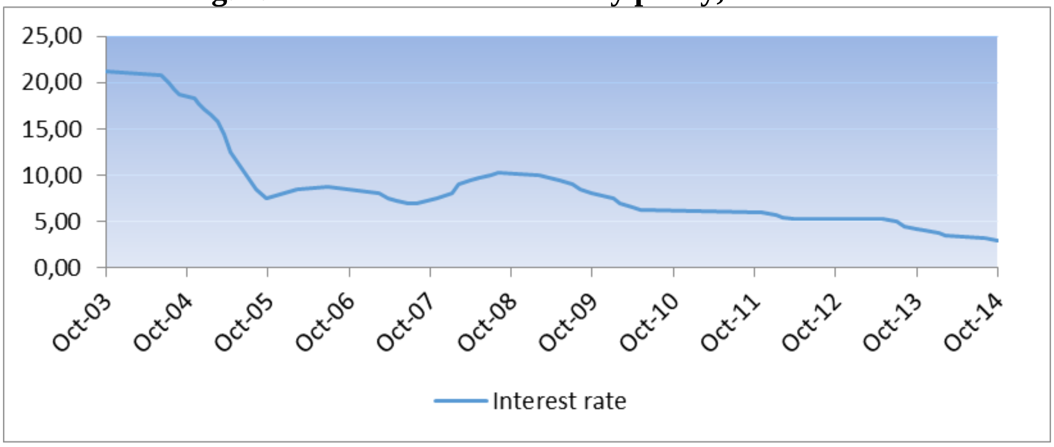
Fig. 1. Broad money supply, 2007-2014, thousand RON



Source: National Bank of Romania

The money supply growth is closely related to the opposite evolution of the monetary policy interest rate. After its sharp decline from 21.25% in the fall of 2003 to 7.5% in the fall of 2005, the outbreak of the economic crisis in Romania is launching a clearly downward trend for interest rate, assisting periodically the reaching of new and new thresholds. From October 1, 2014, the interest rate on monetary policy in Romania reached 3%. In this context, it is necessary to notice that the interest rate do not reflects (anymore) the time preference of individuals, the relationship between current consumption and future consumption, between the supply and demand for monetary resources. While interest rate remain a highly important price, based on which the economic actors act, it does not transmit anything outside the artificial reality drawn by monetary authorities. As a result, it may continue to generate "exuberant" behaviors.

Fig. 2. Interest rate on monetary policy, 2003-2014



Source: National Bank of Romania

The logic of expansive monetary policy intends growth by stimulating consumption through credit. This approach do not differs from that of the boom years, easy access to credit being largely responsible for the paradox of increased consumption and more investment in the conditions of restricting savings. The economic crisis has revealed, in fact, a massive gap between the real and monetary resources. The false signals sent by low interest rates have stimulated the initiation of some investments that would have been unprofitable otherwise. Stimulative monetary policy created the false impression of consumption preferences unsupported by the real level of resources. Once it became clear that economic expansion was a forced, unsustainable one, the real forces impose processes of correction, of readjustment to the real level of resources and consumer preferences. The recession has the meaning to eliminate erroneous business initiated during the years of boom. This is impeded when monetary policy continues to stimulate the lending process. The consumption sustained through monetary policies can mask entrepreneurial errors, delaying the processes of correction.

An important element that should be mentioned when referring to monetary policy is the tight link between the measures of stimulating consumption on credit and inflation. Even if the consumer price index has a trend that do not stirs concerns, on the long-term the expansionary policies not only did not really stimulate consumption, but reduces it through the loss of purchasing power of the currency, subject to inflationary processes of multiplication. Therefore, monetary expansion in the absence of real savings can only generate a short-term, artificial growth.

Leaving aside the discussion on the appropriateness of perpetuating the expansive measures, we cannot help noting that the gradual reduction of the interest rate denotes the weak success of this monetary instrument in stimulating the economy. The economic agents remain reserved about contracting new loans in an uncertain economic, social and political context. The large number of business failures in the years 2007-2009 and the burden of paying back the loans taken in the boom years maintained a certain distance from the promise of prosperity through indebtedness. Distrust in the crediting promise is backed by the threat of increased fiscal pressure.

The efforts of monetary stimulation of the Romanian economy are canceled however by the fiscal constraints. Although monetary policy promises economic growth and price stability, fiscal policy places Romania among the least competitive countries, denying its chance of prosperity.

According to the Doing Business Report conducted by the World Bank, Romania[1] ranks 134 in terms of paying taxes, having 39 payments per year and spending 200 hours per year for this. This position must be understood both in terms of reduced tax morale[2] of Romanians and through the high level of taxes on the income of population. The total tax rate represents 42.9% of commercial profits of companies in Romania. These have to pay 31.5% of their commercial profits in the account of social security contributions, which places Romania on the bottom 171 place of 189 countries. The Global Competitiveness Report ranks Romania on the 140 position of 144 countries analyzed concerning the effect of taxation on incentives to work. The effect of taxation on incentives to invest ranks Romania, according to the same

[1] World Bank, Doing Business 2014, p. 219, available at http://www.doingbusiness.org/~/media/GIAWB/Doing %20Business /Documents/Annual-reports/English/DB14-Full-Report.pdf

[2] Torgler, B. (2003), „Tax Morale in Transition Countries”, *Post-Communist Economies*, Vol. 15, No. 3; Torgler, B. (2007), “Tax Morale in Central and Eastern European Countries*”,* in Nicolas Hayoz and Simon Hug (eds.), *Tax Evasion, Trust and State Capacities. How Good Is Tax Morale in Central and Eastern Europe?,* Bern: Peter Lang, pp. 155-186; Torgler, B. (2011), “Tax Morale, Eastern Europe and European Enlargement”, *The World Bank Policy Research Working Paper* 5911, available at http://www-wds.worldbank.org/external/default/WDSContentServer /WDSP/IB/2011/12/13/000158349_20111213084401/Rendered/PDF/WPS5911.pdf

source, in the position 128[3]. VAT rate in Romania is one of the largest in Europe, surpassed only by Hungary, with 27%, and Sweden and Denmark with 25%. The tax burden on labor is also high, being in close relationship with the black-market[4] economic activities that involve undocumented workers.

James Rogers and Cécile Philippe appreciated in 2011 that, for a Romanian worker, the Tax Freedom Day will be celebrated on July 1, considering that beginning work on January 1st would earn enough to pay his annual tax burden until then[5]. The same authors calculated how much an employers must spend to pay each net euro to an employee. The result for Romania is 1,83 EUR, the seventh most expensive country in Europe from this perspective. In the same time, when compares the "real tax rate" paid by typical workers in each EU member state to that same country's ratio of tax revenue to Gross Domestic Product (GDP), the relatively low percentage of total tax revenue as a percentage of GDP for Romania (28.0%) is in strong contrast with the Real Tax Rate of 49,7%, one of the highest in Europe!

Fig. 3. Taxation of Workers and Tax Revenue as a Portion of GDP

Country	Real Tax Rate	Total Tax as % of GDP
Romania	49.7%	28.0%
Ireland	31.0%	28.2%
Slovakia	46.7%	28.8%
Latvia	48.6%	28.9%
Lithuania	46.2%	30.3%
Greece	46.0%	31.2%
Portugal	42.2%	31.3%
Spain	44.5%	33.6%
Poland	44.4%	31.7%
Estonia	45.1%	32.8%
Bulgaria	37.6%	33.3%
Czech Republic	46.4%	35.3%
United Kingdom	36.4%	35.5%
Hungary	53.7%	35.7%
Slovenia	43.2%	36.8%
Germany	53.0%	37.1%
Luxembourg	39.7%	37.1%
Netherlands	48.6%	38.7%
Cyprus	20.0%	39.2%
Austria	55.8%	42.1%
Italy	52.1%	42.9%

[3] World Economic Forum, *The Global Competitiveness Report 2014–2015*, p. 319, available at http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf

[4] See A.T. Kearney, *The Shadow Economy in Europe,* 2013, available at http://www.atkearney.com/financial-institutions/featured-article/ /asset_publisher/j8IucAqMqEhB/content/the-shadow-economy-in-europe2013 /10192

[5] James Rogers, Cécile Philippe, *The Tax Burden of Typical Workers in the EU 27*, 2011, Institut Économique Molinari, available at http://www.institutmolinari.org/IMG/pdf/tax-burden-eu.pdf

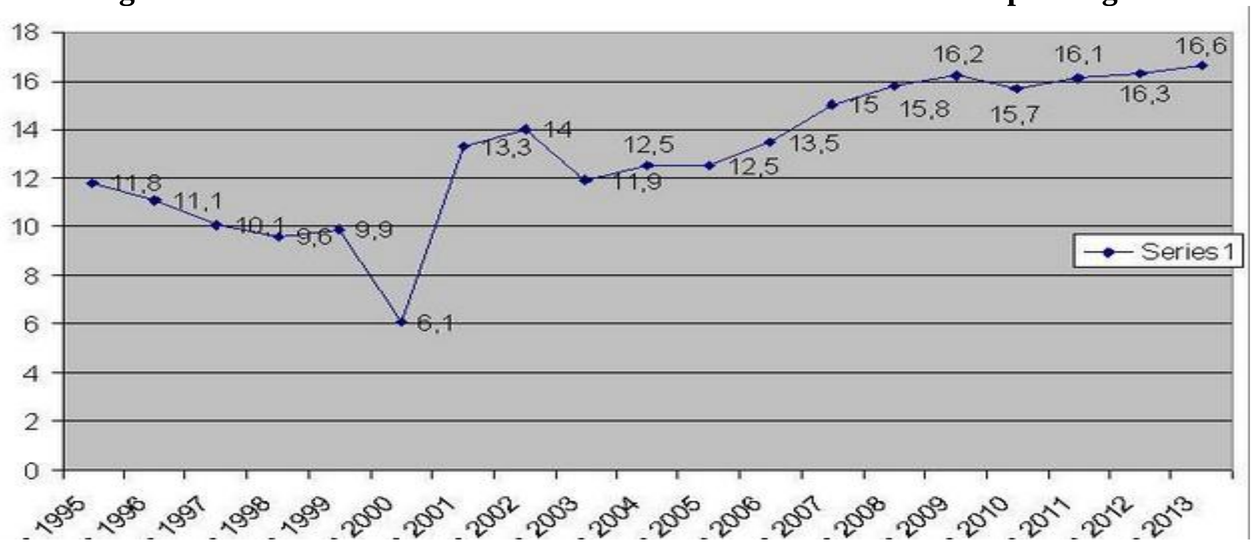
Finland	46.4%	43.4%
Belgium	60.3%	44.0%
France	56.6%	44.2%
Sweden	47.3%	44.5%
Denmark	42.9%	48.1%
Malta	32.4%	48.2%

Source: James Rogers, Cécile Philippe, *The Tax Burden of Typical Workers in the EU 27*, 2013, Institut Économique Molinari, p. 14

In other words, half of workers' incomes are intended, in of direct and indirect forms to the state budget. In this way, each worker is employed, six months each year, in central and local administration, without remuneration. Tax burden becomes heavier year by year. According to the National Institute of Statistics, in the second quarter of 2014, the share of taxes and social contributions accounted for 16.8% of total household expenditure[6], the highest level in the last twenty years.

The upward trend of the expenditure with taxes and social contributions in total families spending rotates is shown in the graph below. Interestingly, the tax expenses and contributions increased by 9% in the past two years, while total expenses increased by only 6%. In other words, consumption growth is confiscated by taxation growth. Under these conditions, the economic growth as measured by Gross Domestic Product evolution has increasingly strong assumptions to be based on the rise of the taxes included in final prices[7], however unfounded by the economic way of thinking might seem.

Fig. 4. The share of taxes and social contributions in total families spending



Source: Ionuţ Balan, apud Bogdan Glăvan, *Un lucru este sigur: cheltuielile gospodăriilor cu impozitele*, http://logec.ro/category/despre-impozite/, October 2014

Thus we have the picture of duality of two macroeconomic policies that aim, paradoxically, the same goal - providing resources to stimulate economic growth. If monetary policy aimed at boosting private activities, fiscal policy seeks to provide resources for economic growth

[6] Institutul Naţional de Statistică, *Veniturile şi cheltuielile gospodăriilor populaţiei în trimestrul II 2014,* http://www.insse.ro/cms/files/statistici/comunicate/abf/ABF_II_r14_n.pdf

[7] See Bogdan Glăvan, *Câte taxe sunt în PIB sau cât PIB este în taxe?*, September 2014, http://logec.ro/cate-taxe-sunt-in-pib-sau-cat-pib-este-in-taxe/

thanks to public actions. It remains the problem of scarce resources and the reality of the impossibility of their concomitant use. Fiscal pressures may not both encourage individual consumption and government consumption, private investments and public investments. The household consumption do not needs monetary stimulus, but rather fiscal relaxation.

3. CONCLUSIONS

Lack of coordination of monetary and fiscal policy in Romania is visible through the expansionary stance of monetary instruments, aimed at boosting growth by encouraging consumption, while fiscal instruments acts as a brake on this, by taking a growing part of the economic actors incomes. The interest rate that goes down threshold after threshold is seconded by tax levy increases. The loss of purchasing power of the currency is backed by lower revenues remaining at the disposal to economic actors. In these circumstances it is difficult to imagine that the Romanian economy can base their momentum, being rather doomed to poverty. Adjustments in the real economy are delayed through monetary instruments, while initiatives are discouraged through fiscal instruments. On the one hand, monetary policy continues to lure the mirage of easy to obtain resources, while fiscal policy awakens to the reality of depleted by tax resources. Having been confiscated a significant portion of their wealth, the ordinary Romanians can resign or can base their economic action on borrowed resources. The result can be a creepy one - we can imagine a monetary policy that provides through credit the needed resources to cover the tax burden.

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