HETEROGENEITY OF FISCAL POLICIES

VODĂ Alina Daniela[1], DOBROTĂ Gabriela[2], CRISTEA Loredana Andreea[1]
[1]Department of Doctoral Studies, Faculty of Economic Sciences, Lucian Blaga University, Sibiu, Romania
[2]Faculty of Economic Sciences, Constantin Brâncuși University, Târgu Jiu, Romania
alina.voda3@yahoo.ro
gabi.dobrota70@gmail.com
crs.loredana@yahoo.com

Abstract: *Understanding the functionality of fiscal policies, as well as its fundamental role in economic balancing, these are important aspects in terms of protecting and developing the business environment with obvious effects on social life. This study delves into the heterogeneity of fiscal policies to create a delimiting framework for them. The two types of fiscal policies, the discretionary or deliberative fiscal policy and the fiscal policy that act as an automatic stabilizer, were debated and detailed. The characteristics of the two types of policies are offered the way of using government revenues and expenditures as fiscal instruments. Thus, deliberative fiscal policies use instruments in directions strictly defined by the government in the sense of economic expansion or coercion. In contrast, fiscal policies that act as an automatic stabilizer do not require government intervention, acting by increasing the number of payments in times of recession and reducing them in times of economic expansion. Automatic stabilizers operate on the basis of state regulations, although their nature, size and effect have not yet been well defined in the empirical literature. The overall picture obtained in this study by researching the types of fiscal policies has allowed us to understand their functionality and the effects they can produce in the economy.*

Keywords: *discretionary fiscal policy; automatic stabilizer; expansionary fiscal policy; contractionary fiscal policy.*

JEL Classification: *E61; E62; H30.*

1. Introduction

The study of fiscal policy is a desideratum in the context of identifying the particularities that underlie the creation of a fiscal protection against the well-known economic crises. Aspects of the nature of those regarding the reaction of fiscal policies to the fluctuations of the business cycle, the political and institutional determinants, but also the social issues, constitute the interest of the debates and empirical analyzes on this topic. The definition of the concept of fiscal policy has received different connotations, due to its consequences on specific areas of research. A broader definition of fiscal policy has been devised by Bhattarai and Trzeciakiewicz (2017), who argue that it has been used on a large scale over time to stabilize the economy, encouraging the development of societies in a more efficient way, fairer and more equitable. Arestis (2012) frames fiscal policy as an automatic macroeconomic stabilizer that should be based only on certain instruments to ensure the broad balance of government expenditures and taxation. For a deeper understanding of the types of fiscal policies and an understanding of their functionality related to the phases of the economic cycle, this article is structured as follows: Section 2 Literature review, Section 3 Diversity of fiscal policies, Section 4 Conclusions, followed by References.

2. Literature review

The applicability of fiscal policies in terms of their characteristics have generated a number of controversies in the literature. An extensive theoretical study was conducted by Günel (2019) who analyzed discretionary tax policy and relations with tax rules. He stated that a policy can be conducted by rules or discretion and fiscal rules are a solution to the predictability and inconsistency of fiscal policy, thus increasing the effectiveness and predictability of fiscal policy. Cristea et al. (2019) studied the determinant factors of fiscal revenues as an important instrument in the fiscal policy application. Fatás and Mihov (2012) conducted an analysis demonstrating that discretionary fiscal policy tends to be acyclic in developed countries and pro-cyclical in emerging countries. Badinger (2009) did not identify any evidence to show that discretionary fiscal policy would have effects on destabilizing inflation. Beetsma (2008) conducts a study analyzing the effects of discretionary fiscal policy stating that most evidence suggests that an increase in government procurement or a reduction in net taxes has a short-term positive effect on economic activity and aggregate consumption and an effect negative on the trade balance. Considering the two types of discretionary fiscal policy, Truger (2015) states that the calls for a more expansive fiscal policy have become stronger, as it becomes clearer that monetary policy alone will not be able to trigger recovery. Weil (2008) emphasizes the institutional enthusiasm for expansionist policies during recessions, which is not matched by the desire for contractionary policies during economic expansion, as the benefits of such a policy are immediately felt, while its costs, future higher taxes and growth lower economic costs are postponed until a later date. Gravelle and Hungerford (2011) conducted a study to identify whether contractionary fiscal policy can also be expansionary, so that the debt problem was analyzed with two options by exposing a still fragile economy to risk by applying a contractionary fiscal policy or exposing to failure by pursuing an expansionary fiscal policy. On the other hand, there are studies in the empirical literature that emphasize the importance and effects of automatic stabilizers in the economy. Andrés and Doménech (2006) state that automatic stabilizers that operate in terms of demand do not compensate for the pro-cyclical movements of aggregate supply, on the contrary, they tend to increase the size of economic fluctuations associated with distorted taxes. The effects of automatic stabilizers were also analyzed by McKay and Reis (2016) and Colciago et al. (2008).

3. Diversity of fiscal policies

Economic stability or instability, the objectives pursued by governments, the degree of economic development, socio-political factors, as well as the phases of the economic cycle, are a series of elements that have been the basis for identifying different types of fiscal policies. Currently, two types of fiscal policies are known, namely, discretionary or deliberative fiscal policy and fiscal policy that acts as an automatic stabilizer, their components being indexed in *Figure 1*.

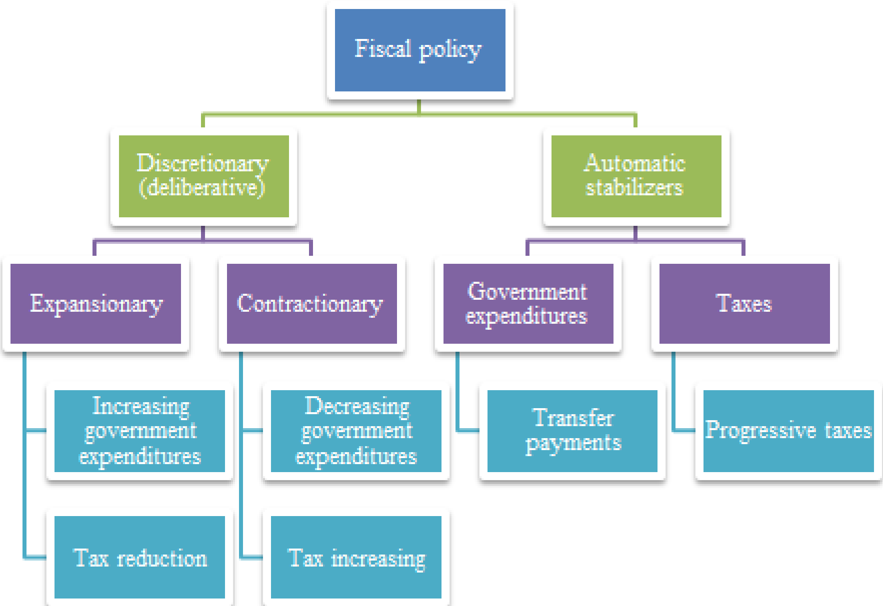
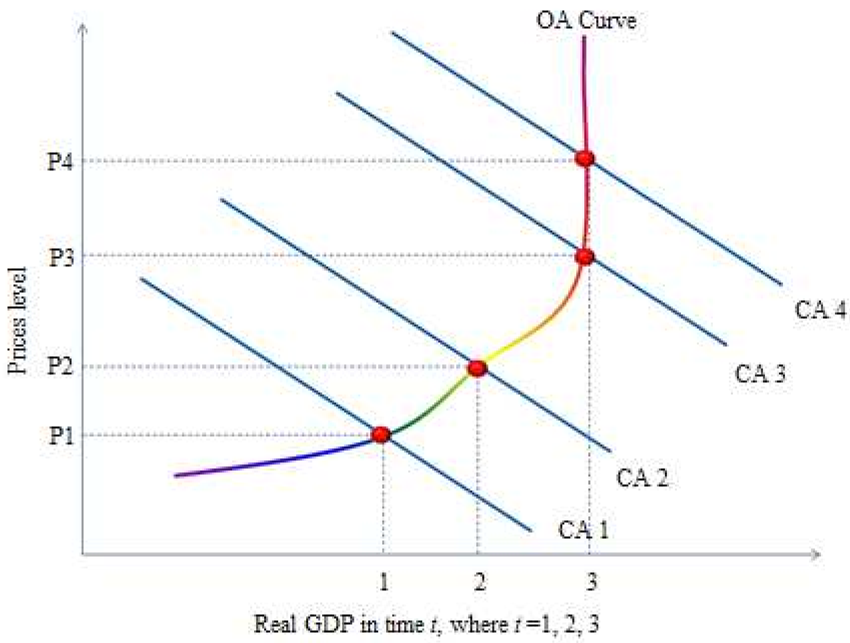


Figure 1: Heterogeneity of fiscal policies
Source: Author processing

Discretionary fiscal policy is classified dichotomously into expansionary fiscal policy and contractionary fiscal policy. The two main instruments of action are government expenditures and taxes that contribute together with other levies to the establishment of government revenues. The impact of discretionary fiscal policy on economic growth was the aim of an analysis by Attinasi and Klemm (2014) in 18 European countries suggesting that the increase in consumption taxes is harmful only during the recession. Arsic et al. (2017) explored the economic, political and institutional determinants of discretionary fiscal policy in 11 Central and Eastern European countries by noting discretionary fiscal responses before and after the global economic crisis, highlighting the existence of a systemic discrepancy between government revenues and expenditures as a consequence of discretionary measures of governments. The heterogeneity of fiscal policies is a prerogative given

to governments to anticipate risks and apply only those measures that ensure sustainable economic growth. The most used category among the fiscal policy is the expansionist one, characterized by the increase of government expenditures and the decrease of taxes and duties, an approach that inevitably encourages the increase of consumption. Such a practice will make it difficult for governments to maintain a balanced budget, as in the absence of a surplus during expansion periods, these will have to act to reduce government expenditures in response to declining government revenues during the recession. Expansionary fiscal policy is defined by Hebous (2009) as a stimulus of the multi-effect economy, in which the increase of government expenditures leads to the stimulation of economic progress in a closed economy as well as in a small economy. In Bingyang's (2011) view, it is used as a method of protecting the economy in times of recession due to low macroeconomic performance in which supply exceeds demand. Given the universal objective of fiscal policies to facilitate economic development, expansionary fiscal policy is presided over by a well-defined mechanism of increasing government expenditures and decreasing revenues in order to stimulate aggregate demand and thus production in times of recession. risks of amplifying the inflationary process as a result of a crowding out effect. This effect occurs when the economy is closed at full capacity, between the limits of CA 3 and CA 4 in *Graph 1*, and loans are constantly growing.
Governments will tend to spend more on private sector lending. In turn, it will be affected by a decrease in investment capacity, with government expenditures having a crowding-out effect on private sector expenditures. The need to identify the effects of increased government expenditures on economic development due to the application of an expansionary fiscal policy, has led to numerous studies. Thus, Chugunov and Pasichnyi (2018) demonstrated that episodes of expansive fiscal adjustments based on government revenue cuts and expenditures increases were more efficient compared to those that relied entirely on expenditures increases, a statement that was substantiated by the analysis achieved in the emerging economies of the Member States of the European Union. Hebous (2009) questions whether fiscal expansion is effective in stimulating the economy following a study that examined theoretical predictions and empirical evidence from autoregressive vector analysis (VAR) to identify short-term effects of discretionary fiscal policy on macroeconomic aggregates. Contrary to the above, Mahmoudzadeh et al. (2017) analyzed the effects of expansionary fiscal policy in developed and emerging countries, arguing that the application of such a policy can lead to economic growth. This assertion is also supported by those identified by Truger and Nagel (2016), who highlighted the adoption of expansionary fiscal policy in most euro area countries since the spring of 2014, when monetary policy could no longer independently help revive the economy. Contractionary fiscal policy is an antithesis of expansionary fiscal policy due to instruments that act as a reverse mechanism to stimulate the economy. Its restriction is due to higher taxes and lower government expenditures. The effect is rapidly visible in the economy due to the reduction in the amount of capital available. Although the measures imposed by such a policy are not sympathetic to the business community and citizens, they ensure a slow but sustainable growth of the economy. Inflationary expectations are much more present than in the case of expansionary fiscal policy because the increase in taxes and fees

will result in higher prices and destabilization of living standards. Auerbach (2002) states that budgetary pressure could destabilize the positive effects of expansionary fiscal policy, however, contractionary fiscal policy will have a salutary effect on economic growth. The usefulness of applying contractionary fiscal policy is argued by Periklis and Pragidis (2015) who argue that the use of government revenues as a tool to stabilize the economy, in the sense of increasing taxes and duties, will help reduce demobilizing influences on production.



Graph 1: Fiscal policy synchronization
Note: CA represents the aggregate demand, and the OA Curve represents the aggregate supply curve
Source: Author's processing after Carlson, Spencer (1975, pp. 5, 7) in the vector graphics editor Corel Draw

The aspects highlighted by Fatás (2019) contradict the positive effects of contractionary fiscal policy, stating that following the economic crisis of 2008 many European countries were destabilized by their own actions in an attempt to recover, and the application of such policies produced negative effects, predominantly over gross domestic product. Despite the contradictory arguments brought to the efficiency of the application of the contractionary fiscal policy, this is defined by Neto (2017) as an incentive offered to countries facing a budget deficit. However, there are many limitations to this approach as contractionary fiscal policy is characterized by budget surplus, requiring increased taxes and fees while reducing government

expenditures only during periods of economic expansion to avoid expansionary anticipations and facilitate sustainable economic development.
The second type of fiscal policy is that which acts as an automatic stabilizer. Business cycle fluctuations are spontaneously balanced without the need for government or other decision-making. Tools used as automatic stabilizers are government expenditures through the social transfer system and progressive taxes on corporate income or profits. Dolls et al. (2012) noted that the operation of automatic stabilizers play a key role in stabilizing demand and production. In another perspective, they are defined by Eaton and Rosen (1980) in the light of the classical instruments used in fiscal policy, having the role of harmonizing production fluctuations without the need for discretionary action by governments. In its own sense, the fiscal policy acting in the form of an automatic stabilizer is determined by the interference of government expenditures, mostly represented by transfer payments, with government revenues, which work as a mechanism to reduce changes in the business cycle in the absence of government implications. The automatic stabilizer, which includes the use of progressive taxes, works by setting differentiated rates that are higher where revenues are higher, a result assimilated to periods of economic expansion, and in the event of their decrease during recessions there are also reduced, proportional tax rates with the income obtained. The role of corporate tax, which must act as an automatic stabilizer, was analyzed by Buettner and Fuest (2010) showing that the stabilizing effect is fluctuating over a business cycle and tends to increase during periods of recession. Regarding the role of government expenditures as an automatic stabilizer in the economy, most of the adversities in the empirical literature are focused on transfer systems in the field of social unemployment insurance. They act as a buffer by increasing the number of payments in times of recession and reducing them in times of economic expansion based on a series of state regulations, thus eliminating government intervention in this process. In an analysis of 20 OECD member countries, Darby and Melitz (2008) found that social costs related to age and health, as well as other benefits for the disabled, react to fluctuations in the business cycle in a stabilizing manner. The results of this analysis are in opposition to those found by Arze del Granado et al. (2013) according to which social expenditures follows an asymmetric pattern in developing countries, these effects being acyclic, in addition, the degree of cyclicality is higher the lower the level of economic development.

4. Conclusions

Fiscal policy must be applied in order to restore economic balance and reorient towards sustainable development. Its applicability has multiple implications on socio-economic life. Taking into account the etymology of the word discretion, this type of fiscal policy acts as a prerogative recognized by law for a government to take measures to balance the economy. There are a number of differences, both among practitioners in the field and among academics, regarding the effects that expansionary fiscal policy and contractionary fiscal policy have on the economy, as well as on the extent to which they can bring necessary benefits to balance or development without exceeding them. The functionality of automatic stabilizers is positioned in a sphere of uncertainty. Their nature, size and effect have not yet been well defined in the empirical literature. Establishing benchmarks in order to identify their relevance in balancing the economy as a result of cyclical fluctuations can improve the expected projections. Moreover, the clear delineation of the effects produced individually by each automatic stabilizer will help to formulate realistic assertions to be framed in a concrete mechanism in which they work together. Understanding the nature, size and delimitation of their effects will contribute to the normalization of business cycle fluctuations, which currently cause major management difficulties for many governments.

References

1. Arestis, Philip. (2012) "Fiscal policy: a strong macroeconomic role", Review of Keynesian Economics, Vol. 1, No. 1, pp. 93-108.
2. Arsic, Milojko, Nojkovic, Aleksandra and Randjelovic, Sasa. (2017) "Determinants of discretionary fiscal policy in Central and Eastern Europe", Economic Systems, Vol. 41, No. 3, pp. 367-378.
3. Attinasi, Maria-Grazia and Klemm, Alexander. (2016) "The growth impact of discretionary fiscal policy measures", Journal of macroeconomics, No. 49, pp. 265-279.
4. Auerbach, Alan. (2002) "Is there a role for discretionary fiscal policy? "National Bureau of Economic Research, NBER Working Paper Series, No. w9306.
5. Badinger, Harald. (2009) "Fiscal rules, discretionary fiscal policy and macroeconomic stability: an empirical assessment for OECD countries", Applied Economics, Vol. 41, No.7, pp. 829-847.
6. Beetsma, Roel. (2008) "A survey of the effects of discretionary fiscal policy", Swedish Fiscal Policy Council (Finanspolitiska rådet), No. 2.
7. Bhattarai, Keshab and Trzeciakiewicz, Dawid. (2017) "Macroeconomic impacts of fiscal policy shocks in the UK: A DSGE analysis", Economic Modelling, Vol. 61, pp. 321-338.
8. Bingyang, Lü. (2011) "Fiscal Policy Expansionary and Macroeconomic Unbalance: Which is the Reason?[J] ", Economic Research Journal, Vol. 3, pp. 18-31.
9. Buettner, Thiess and Fuest, Clemens. (2010) "The role of the corporate income tax as an automatic stabilizer", International Tax and Public Finance, Vol. 17, No. 6, pp. 686-698.
10. Carlson, Keith M., Spencer, Roger W. (1975) "Crowding out and its critics", Federal Reserve Bank of St. Louis Review.
11. Chugunov, Igor and Pasichnyi, Mykola. (2018) "Fiscal stimuli and consolidation in emerging market economies", Investment Management and Financial Innovations, Vol. 15, No. 4, pp. 113-122.
12. Cristea L.A., Vodă A.D., Ungureanu D. M. (2019) "Determinant Factors of Fiscal Revenues, under Current Economic Conditions", Proceedings of the 16th International Scientific Conference ”European Financial Systems 2019”, Web of Science Database CPCI-SSH (Conference Proceedings Citation IndexSocial Science & Humanities), ISBN:978-80-210-9338-6, WOS:000503222600009.

13. Darby, Julia and Melitz, Jacques. (2008) "Social expenditures and automatic stabilizers in the OECD" Economic Policy, Vol. 23, No. 56, pp. 716-756.
14. Dolls, Mathias., Clemens, Fuest., and Peichl, Andreas. (2010) "Automatic stabilizers and economic crisis: US vs. Europe", National Bureau Of Economic Research, NBER Working Paper Series, No. 16275.
15. Eaton, Jonathan and Rosen, Harvey S. (1980) "Labor supply, uncertainty, and efficient taxation", Journal of Public Economics, Vol. 14, No. 3, pp. 365-374.
16. Fatás, Antonio and Ilian Mihov. (2012) "Fiscal policy as a stabilization tool", The B.E. Journal of Macroeconomics, De Gruyter, Vol. 12, No. 3, pp. 1–68.
17. Fatás, Antonio. (2019) "Fiscal policy, potential output, and the shifting goalposts" IMF Economic Review, Vol. 67, No. 3, pp. 684-702.
18. Günel, Tuğay. (2019) "Discretionary Fiscal Policy and Fiscal Rule Relationship: Theoretical Approach", Theories and Critics in Economics and Management, No. 18, pp. 297-308
19. Hebous, Shafik. (2009) "The effects of discretionary fiscal policy on macroeconomic aggregates: a reappraisal", Munich Personal RePEc Archive, No. 23300, pp. 1-23.
20. Mahmoudzadeh, Mahmoud, Sadeghi, Somaye and Sadeghi, Soraya. (2017) "Fiscal expenditures and crowding out effect: a comparison between developed and developing countries", Institutions and Economies, Vol. 5, No. 1, pp. 31-40.
21. Neto, Antonio Soares Martins and Porcile, Gabriel. (2017) "Destabilizing austerity: Fiscal policy in a BOP-dominated macrodynamics", Structural Change and Economic Dynamics, No. 43, pp. 39-50.
22. Periklis, Gogas. and Pragidis, Ioannis. (2015) "Are there asymmetries in fiscal policy shocks? ", Journal of Economic Studies, Vol. 42, No. 2, pp. 303-321.
23. Truger, Achim. (2015) "The fiscal compact, cyclical adjustment and the remaining leeway for expansionary fiscal policies in the Euro area", Panoeconomicus, Vol. 62, No. 2, pp. 157-175.
24. Truger, Achim and Nagel, Michael. (2016) "Austerity, cyclical adjustment and how to use the remaining leeway for expansionary fiscal policies within the current EU fiscal framework", Turkish economic review, Vol. 3, No. 2, pp. 235-255.