FISCAL POLICY – MAIN COMPONENT OF DURABLE DEVELOPMENT STRATEGY

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Abstract

Any strategy of durable (economic) development must acquit itself, first and foremost, of basic need of actually *yielding economic development. For this, a mix of economic policies are needed and used, most important being fiscal policy and monetary policy: the former is needed for building up aggregate demand, the latter, for expanding aggregate supply. As for the unavoidable (potential) drawbacks – i.e., of using both of this policies at once (and some others besides) –, monetary inflation is at hand, and maybe just a little more harmful as (the need of)* inflating *real economy itself; for, in the end – and this is not necessarily always understood –, what any durable development strategy amounts to is 'pilfering' some of future's resources for bolstering the present, with same resources.*

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As for *durable development*, relevant literature – written inclusively *before* and *after* unravelling of an economic crisis (i.e. 2008 crisis) – does *not* provide us, on the whole, with a definition, even less with a complete theory, but with *a system* of convergent points of view, sufficient for a build-up of a number of plausible *perspectives* for putting together a durable development strategy.

Therefore, durable development must be understood as being, in the same time:

1. The type of development which allows satisfaction of i.e. a nation's needs, *in the long term*, in other words paving the way for the 'insurance' of that nation's *future*[1];
2. Type of development which allows satisfaction of *current* needs of a community – i.e. nation/country –, without compromising ability of *future* generations sprung from the midst of that community to satisfy *their* own needs as well[2].

In this perspective, fiscal policy can and should be used as component of a durable development strategy, especially directly, by stimulating economic growth – i.e. *moderately* sized one, that is one whose level is high *enough* to make it able to (re)shape

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[1] Dobrescu, E., Albu, L.L. (2005), *Dezvoltarea durabilă în România (modele şi scenarii pe termen mediu şi lung)*, Editura Expert, Bucureşti, p. 25.

[2] World Commission on Environment and Development (WCED), Our Common Future (New York: Oxford University Press, 1987), 8.

– for the better – the *growing* society. Thus, it is needed both to identify the mechanism through which fiscal policy yields economic growth and (possible) methods of producing a *moderate* economic growth.

Value of economic growth is *understood* – for real economy – to equate (i.e. to identify *with*) value of growth of goods and services output, given index used to measure economic growth is GDP, used, in fact, to compute **added value** of real economy – namely, in principle, *net* value of *all* activities which make up real economy.

Inputs – analysing the *process* of economic growth – used to *produce* economic growth are production factors used by real economy, namely:

A. <u>Primary production factors</u>, namely:

I) capital – materialised in the form of capital assets, made up of all previously produced – i.e. by the same economy – goods (material assets – machinery, tools, etc. and immaterial assets – patents, brands, software, etc.) and used for obtaining added value (at national level);

II) labour (that can be defined, in physical terms, as human *mechanical work*);

III) knowledge (i.e., human capital).

B. <u>Derived production factors</u> – *produced* by/in the very *structure* of (market) economy, structure energized by organizational and managerial processes and procedures, namely:

IV) (efficient) resource allocation;

V) scale economy.

To sum it up, *output* of goods and services can grow, in principle, through (main) use of one of the following two alternative courses of action:

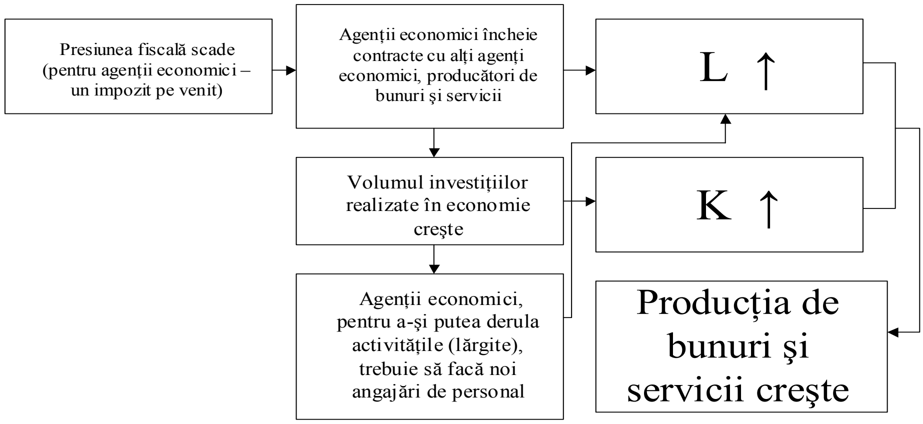
a) Rise of production process ***yield*** – at all levels, *starting* from firm level, building up at (economic) branch level and, finally, 'converting' into economic *growth* at (national) real economy level;
b) Broadening of material and energy base of economic growth, respectively of quantity of used production factors – most important ones being, in this respect:
   i. Capital assets;
   ii. Number of employees;
   iii. Amount of knowledge.

Rise of production process yield, or broadening of *real* basis of economic growth is the result (in first instance), or the driving force (in the second one) of *aggregate offer* (long term) growth. In other words, economic growth can *only* be obtained through rise in aggregate offer of goods and services yielded by real economy.

In this point, we must underline fiscal policy spurs on economic growth not only as it is, itself, applied in realm of *production* and *commerce* of/with goods and services, but through its influence on labour market: a reduction of fiscal pressure in this realm allows firms to earn (i.e., to retain) a certain *extra* amount of financial funds, on one hand, and makes them *dependent* on (continuous) recruiting of personnel, in order to further business development, on the other hand.

As a result, a fiscal policy that 'puts up with' both employers and employees has the capacity to rise aggregate offer; in relevant literature several representations of *these* relationships and influences between fiscal policy and economic growth can be found, one adequate example being the following:

The influence of dwindling fiscal pressure on good and services output growth



Source: Predescu, A. (2013), *Impozitarea veniturilor şi creşterea economică*, Editura Universitară, Bucureşti, p. 59.

Technically speaking, a low(er) fiscal pressure is to be obtained – globally, that is at *economy* level – through emission of a *fiscal impulse*, respectively of most important effect of public administration decision-making as to choosing between following practical alternatives of *fiscal action-taking* needed for reaching the goal of rise in aggregate demand:

I. a decrease of tax rate as regards one or more taxes (decrease valid as well for labour market taxation)
II. rise in government spending
III. rise of transfer payments.

Size of fiscal impulse *should* be computed in such a manner that entities in charge of fiscal policy (state institutions, public administration, etc.) will aim, in the same time, at reaching of following goals:

(1) Firstly, ('ideal' dimensioning of) *average* total expenditure size taxpayers must deal with on a daily basis;
(2) Secondly, (desired) level of *national income* – i.e., a level which allows/stimulates ongoing recording of effective economic growth (ideal being using fiscal policy for and through use of whole labour *potential* as available between the limits of real economy).

Total value of financial funds[3] obtained through rise in government spending – used *de facto* for rise in aggregate demand – is (sensibly) higher than total value of government spending *proper*, amplitude of financial funds used by government for its spending being

[3] Whose value can be computed thus: variation of government spending x multiplier (itself determinable using following formula – multiplier = 1/(1-c), where c = marginal propensity to consume (MPC)).

subjected to a multiplication process, generated by the indirect – albeit massive – impact of firms' *consumption*, as reaction to state action*s*, in its quality of 'supreme' firm.

Thus, initial (fiscal) impulse emitted by government administration – through an increase in *its* spending - is, in this case, amplified by market economy mechanisms; but, on the other hand, there is, too, the risk of something going awry - i.e. inflation, if rising spending are excessively high relative to (initial) ***price level*** as regards market economy as a whole.

Another way of emitting a fiscal impulse is reducing tax rates, for one or more – or all – taxes. Unlike rising government spending, reducing tax rates produces a rise in consumption, in a two-step dynamics: in first step, a rise in consumption proper is recorded[4], which, through a multiplication process similar to the one described above, rises to a superior level[5].

A rise in volume of transfer payments (i.e. social security (state) expenses) also emits a fiscal impulse, useful for stimulating growth of global consumption (in other words, of aggregate demand); but, in this case, the result is consumption grows less[6] than transfer payments themselves, due to savings effect: some of those funds will find their way – i.e. in Romanian economy – in banking system, or in financial market.

Whichever method is used in order to emit a fiscal impulse, however, it is less important than *utility* of such action – which is simply inconceivable but *relative to* ultimate goal of *any* economic policy, that is nothing else, at least in a market economy, than experiencing *useful* and *effective* economic growth in the long term.

For this, and, in fact, whatever main objective of fiscal policy might be, this very policy will be prepared, anywhere a market economy exists, starting from most favorable alternative of (fiscal) materialization of all principles of fiscal policy – one having to choose between direct income taxation and indirect income taxation as ***main method*** of collection of fiscal revenues in the benefit of public budget.

If, as it seems logical and 'fair' to us, strategy for economic growth is based on (strategic) principle of *growth of* national (i.e. vernacular) *economy* as means for obtaining economic growth in the same (geographic) space, then, according to relevant literature as well, we cannot but observe that – at least for and in a market economy – it is highly recommended to mainly use *direct* income taxation, simultaneously with using consumption itself as a tool for economic growth – i.e. inclusively with use of indirect income taxation –, with the caveat consumption must *not* be *overtaxed*, so that, finally, economic growth may be got hold of[7].

But, fiscal policy is not the only tool available for public authorities, and, furthermore, cannot be and will not be used exclusively, but only in its quality of component of a *policy mix* – one of most important *other* policy being monetary policy.

Impulses emitted through monetary policy use, must be admitted, expose economy to risk of (rise in) inflation – it must be observed, a case similar to that of fiscal policy

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[4] Its formula being: c x amplitude of tax reduction (in monetary units).

[5] Whose value can be computed using following formula: initial growth of consumption x multiplier.

[6] This can be determined using folowing formula: c x transfer payments growth (in monetary units).

[7] Auerbach, Alan J. (2006), *The Future of Capital Income Taxation*, University of California, Berkeley; Predescu, A. (2013), *Impozitarea veniturilor şi creşterea economică*, Editura Universitară, Bucureşti.

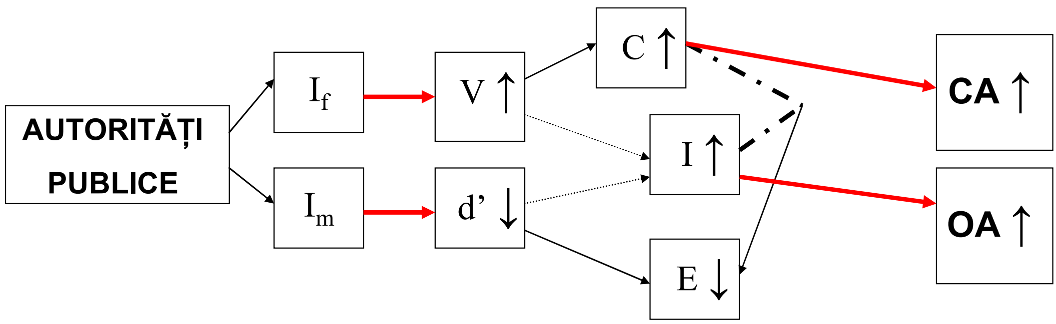
use, and, not to be unsaid, more probable than in the latter case; however, it must be heavily underlined main function (and utility) of monetary impulse – whose mechanism aims, firstly, at growth of *aggregate supply* (i.e. of real economy proper), through:

1. simulation of rise in MPI (marginal propensity to invest), on one hand, and
2. a well-engineered 'discouragement' of saving behaviour, on the other hand.

Consumption growth *must*, therefore, be correlated to a decrease of interest rate; for this to be accomplished, it must not be overlooked that, once an economy reaches a point close to that of maximum degree of use of (all) its resources, probability that monetary impulse – in fact, that *any* impulse – will boost inflation rises sharply.

What is at work here is a *trade-off* – to be more precise, a very important reality (and, as such, for this paper, conclusion): economic growth cannot be sustained, in the long term, with a high degree of probability, without (some) rise in inflation; all that policy makers – and, especially, policy *users* – *can* choose is the level up to which it may reasonably be considered inflation, to put it plainly, *it's worth it*, without damaging (i.e. too much) both economy and society.

The mechanism of simultaneously *using* fiscal and monetary impulses – in a market economy –, described in this paper, is adequately illustrated in relevant literature, *exempli gratia*[8]:



Mechanism of (simultaneously) using fiscal and monetary impulses
Source: Predescu, A. (2013), *Impozitarea veniturilor şi creşterea economică*, Editura Universitară, Bucureşti, p. 75.

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World Commission on Environment and Development (WCED), Our Common Future (New York: Oxford University Press, 1987).

[8] Where I_f = fiscal impulse, I_m = monetary impulse, C = consumption, E = savings, V = incomes, CA = aggregate demand and OA = aggregate offer.