



The Effect of Fiscal Policy Measures on the Budget Deficit

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Taxation is the result of a compromise between different interest groups whose claims are often contradictory. Taxpayers, individuals or legal entities, want to pay taxes as low as possible, but to have the highest possible benefits from the state: free and quality education, high-performance medical system, competent and sufficient police, an efficient legal system, and companies want a lower tax burden, well-trained workforce, affordable know-how. This means, in fact, that economic efficiency is determined by several factors, but also by significant mandatory levies (taxes and duties). In order for the state to be able to ensure these benefits for its taxpayers, it needs resources, which, in order to be collected, need strict rules, laws, which on the one hand have a coercive character, and on the other hand to encourage taxpayers to pay taxes.

Keywords: fiscal policy, budget deficit, tax burden, economic growth, inflation rate, interest rate

JEL Code: E62, H32, H62

1. Introduction

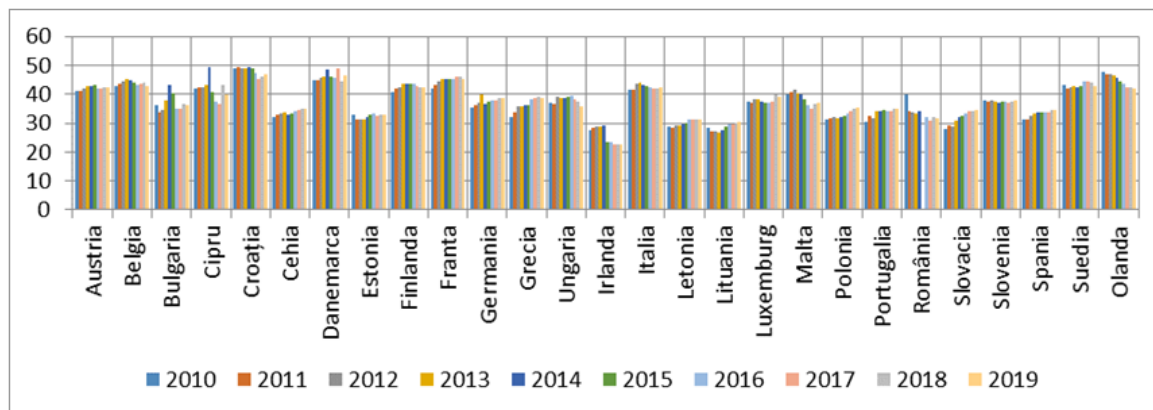
Fiscal policy is the set of measures initiated and implemented by the Government to achieve and maintain the macroeconomic balance in a country's economy (Toader, 2013). The tools through which this process is carried out are taxes, fees, other mandatory levies, but also public expenditures.

Fiscal policy is not the only component of a country's economic policy, it is directly related to financial and budgetary policy, influencing one other. It is not possible to take action within one without influencing elements within the other. That is, the objectives of fiscal policy must have the same coordinates as those of financial and budgetary policy, for example to ensure economic growth (Hicks, 1968) and counteract the economic recession. However, fiscal policy also has independent functions such as: "conscious use of state budget revenues to influence economic and social life" (Toader, 2013).

Fiscal policy must find the optimal level of taxes so that their effect is economic growth and not the generation of negative effects that alter economic mechanisms. The relationship between taxation - economic growth is one of the major challenges for governments, not only in the European Union (EU), but also globally (although in EU countries, especially in the Eurozone, have the highest level of taxation).

The ability of an economy to finance its deficits depends not only on the size of the annual deficit, but also on the inflation rate, the interest rate and the growth rate of the economy. Figure no. 1 shows graphically the share of revenues in GDP for the 27 EU member states.

Figure no. 1. The share of taxes in GDP for the 27 EU member states



Source: <https://data.oecd.org/tax/tax-revenue.htm>, <https://appsso.eurostat.ec.europa.eu/nuj/submitViewTableAction.do>, accessed on 15.02.2021

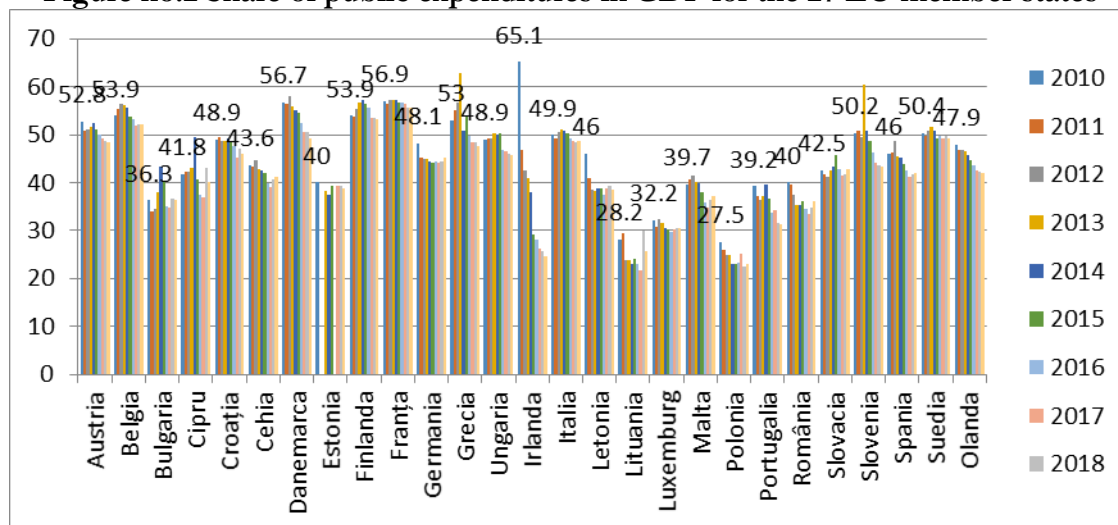
Analyzing the above data, we note that, in 2010, the share of tax revenues in Romania's GDP (40%) was similar to that of developed EU countries: Austria (40.96%), Finland (40.56%) , Italy (41.70%). Analyzing the same data, it is observed that in the 10 years analyzed, almost all countries recorded increases in the share of tax revenues in GDP, except: Romania, whose revenues fell by 9.75%, Hungary 1.03%, Ireland 12 %, Malta 1.07% and the Netherlands 11.4% in 2019 compared to 2010, countries where this decrease occurred as a result of the reconsideration of tax policies promoted by the authorities.

In all other countries, there is an increase in the share of tax revenues in GDP as a result of either legislative changes to increase different tax rates or better collection. Slovenia is a special case, as the level of this indicator is relatively constant throughout the period (approximately 37%).

Comparing to Romania, in 2017 was registered the lowest level of the analyzed indicator, namely 30,8%. This year was the year in which the VAT rate decreased to 19% (the first decrease was on 01.01.2016 from 24% to 20%, and then from 01.01 2017 from 20% to 19%, level maintained until now) . In 2017, Romania recorded the highest rate of economic growth in the last 10 years "amid the transition from the post-crisis recovery stage to the boom phase" (Fiscal Council, 2017). This increase was due to the increase in consumer spending by 6.4% of the total increase of 6.9%. In the same year, the excise duties decreased, the construction tax was eliminated (non-taxable limit up to 450,000 lei), the minimum wage was increased, which determined the decrease of the companies' profit, the limit for micro-enterprises was changed from 100,000 euros to 500,000 euros, amount at which the profit tax is paid.

We cannot discuss fiscal policy without focusing on public expenditures, the size of which has a major influence on economic and social processes. They represent the obligation of the state to provide "economic and social infrastructure" (Fiscal Council, 2017) – vital for economic agents. Figure no. 2 shows the share of public expenditures in GDP for EU member states.

Figure no.2 Share of public expenditures in GDP for the 27 EU member states



Source: <https://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do>, accessed on 15.02.2021

Except for Slovakia, which saw a 0.2% increase in public spending as a share of GDP, all other EU member states saw a decrease in this indicator.

Analyzing the data from the graph above, it is found that the countries of Western Europe with developed economies, have the highest level of public debt. Its level is around 50%, expressed as a percentage of GDP, of which Germany has 48.1% and France 56.9%. Ireland has the highest level in 2010, at 65.1%, which faced major problems during the 2007-2008 financial crisis, which is why we did not take them as a benchmark in this analysis. It is remarkable that, from the highest level, it managed to reduce this indicator to a level of 24.5%. Only Poland has a lower value, of 23%, but it had a low level in 2010 of 27%, and the lowest value was recorded by Lithuania in 2017 of 21.8% of GDP.

Romania followed the decreasing trend of the EU member states, reaching from 40% of GDP in 2010 to 36.1% of GDP in 2019, registering the lowest level in 2017 of 33.5%.

Fiscal policy can be expansive or restrictive. In the first case, the government can increase the level of demand by adjusting the budget with the effect of increasing expenditures or lowering taxes. Companies will lose the benefit of lowering debt financing taxes. Also, the increase in public expenditures can lead to higher sales and, implicitly, higher profits, therefore, taxes used in the form of domestic capital will be available and preferable. Under restrictive fiscal policy, the effect is the opposite (Mokhova and Zinecker²⁰¹⁴).

The government resorts to debt when expenditures exceed revenue and it is not possible to raise taxes or cut expenditures. The presence of a well-functioning public debt market encourages the development of an efficient financial market. The development of a financial market is essential to ensure stable economic growth. Moreover, a stable and efficient financial market provides long-term loans for companies (Langdana, 2016).

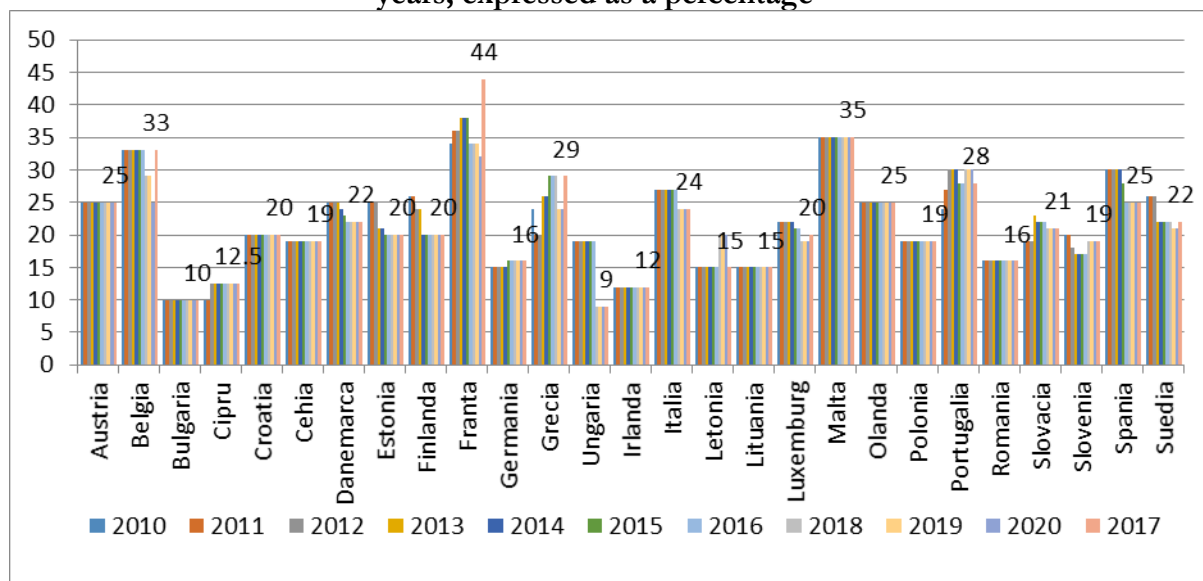
2. History of changes in fiscal policy regarding taxes and fees

In order to have an overview of the evolution of taxation in the last 10 years in EU member states, we conducted an analysis of the main types of taxes, namely corporate tax rates, income tax and VAT.

Income tax is a direct tax that is nominally levied on legal entities and is an important tax lever. The size of this indicator is not only reflected in the volume of receipts, but also in

the degree of collection. It can be seen from Figure no.3 that shows the evolution of corporate income tax for the 27 EU member states, that developed countries have a higher level of this tax compared to countries with emerging economies.

Figure no. 3 Evolution of corporate income tax in EU member states over the last 11 years, expressed as a percentage



Source: <https://stats.oecd.org/Index.aspx?QueryId=78166>, accessed on 18.02.2021

<https://home.kpmg/cy/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>, accessed on 20.02.2021

Following the analysis of the data presented above, several situations are observed:

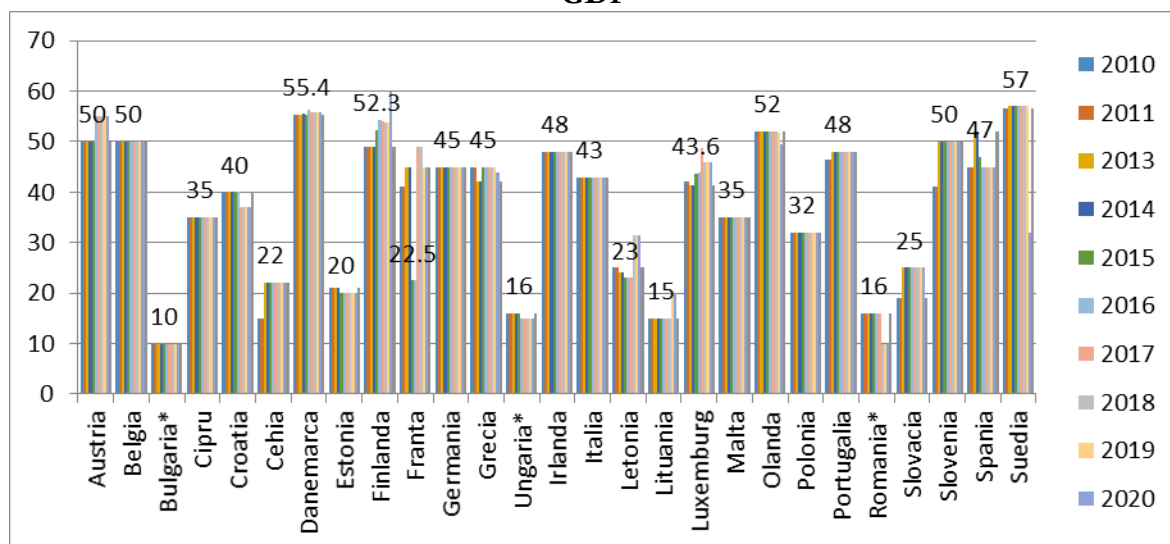
- countries that have kept the corporate tax rate constant: Austria (25%), Bulgaria (10%), Croatia (20%), Czech Republic (19%), Germany (15-16%), Ireland (12%), Lithuania (15%), Malta (35%), the Netherlands (25%) Poland (19%), Romania (16%);
- countries with a declining tax rate: Belgium (33% → 25%), Denmark (25% → 22%), Estonia (25% → 20%), Finland (26% → 20%), Hungary (19% → 9%) the largest decrease, Italy (27% → 24%), Luxembourg (22% → 19%), Spain (30% → 25%), Sweden (26% → 21%);
- countries with an increasing trend in the tax rate: Cyprus (10 → 12.5%), Latvia (15% → 20%), Portugal (24% → 30%);
- However, France did not have a constant evolution of this indicator, registering fluctuations from 34% in 2010, to 38% in 2013, 2014, 2015, reaching the maximum value in 2017 of 44%, then decreasing to 32% in 2020, registering the largest increase, by 10 percent. Greece is in a similar situation, from 24% in 2010 to 20% in 2011 and 2012, reaching 29% in the period 2015-2018, returning to 24% in 2019 and 2020. Slovenia also showed smaller fluctuations from 20% in 2010, in 2011 reaching 17% in the period 2013-2016, then increasing the tax rate to 19% from 2017 until now.

However, 11 countries recorded an increase in corporate tax in the 11 years analyzed, and another 11 countries had the same level of tax rate in these 10 years. As a result, of the 28 EU member states, only 6 have seen tax increases. In 2010, the average level of corporate tax

in EU member states was 31.6%, a continuous decrease over the last decade, reaching the current level of 21.9%.

Income tax is also part of the category of direct taxes, and in the formation of state revenues, the largest share is held by income tax (50%) (Toader, 2013). Its level should be shaped so as not to encourage "undeclared work" and tax evasion. Also, as in the case of corporate tax, I think this is one of the reasons why the countries of the former communist bloc have lower values for this tax and even the flat rate income tax. Figure no. 4 shows the evolution of income tax for the 27 EU member states.

Figure no. 4 Evolution of income tax in EU member states over the last 11 years, expressed as a percentage of GDP



Source: <https://home.kpmg/cy/en/home/services/tax/tax-tools-and-resources/tax-rates>, accessed on 21.02.2021

<https://op.europa.eu/en/publication-detail/-/publication/c0b00da7-c4b1-11ea-b3a4-01aa75ed71a1>, accessed on 18.02.2021

* countries have a flat rate income tax. For the other states, which have progressive tax, the maximum tax rate applied was analyzed, depending on income.

It is observed that only 3 states have a flat rate income tax (Bulgaria, Hungary and Romania) the percentage varying between 10% and 16%. Also, developed countries in central, but especially in Western Europe, have high tax rates, reaching up to half of gross income.

From the analysis of the 10 years we find that the variations of the tax rates were reduced, registering decreases by 1% (Hungary, Estonia, Denmark), 2% Netherlands, 3% Croatia, 6% Romania, 7% Czech Republic. Tax rate increases were also not significant, with fluctuations of 1.5% in Portugal, 5% in Lithuania, 6% in Slovakia and 9% in Slovenia.

Also, even if it is hard to believe, there are EU countries that during the analyzed period did not change the income tax, remaining constant throughout the 10 years (Belgium 50%, Bulgaria 10%, Cyprus 35%, Germany 45%, Ireland 45%, Italy 43%, Malta 35%, Poland 32%). The rest of the EU-27 countries had fluctuations in this tax, in the sense that they registered both increases and decreases of the quota.

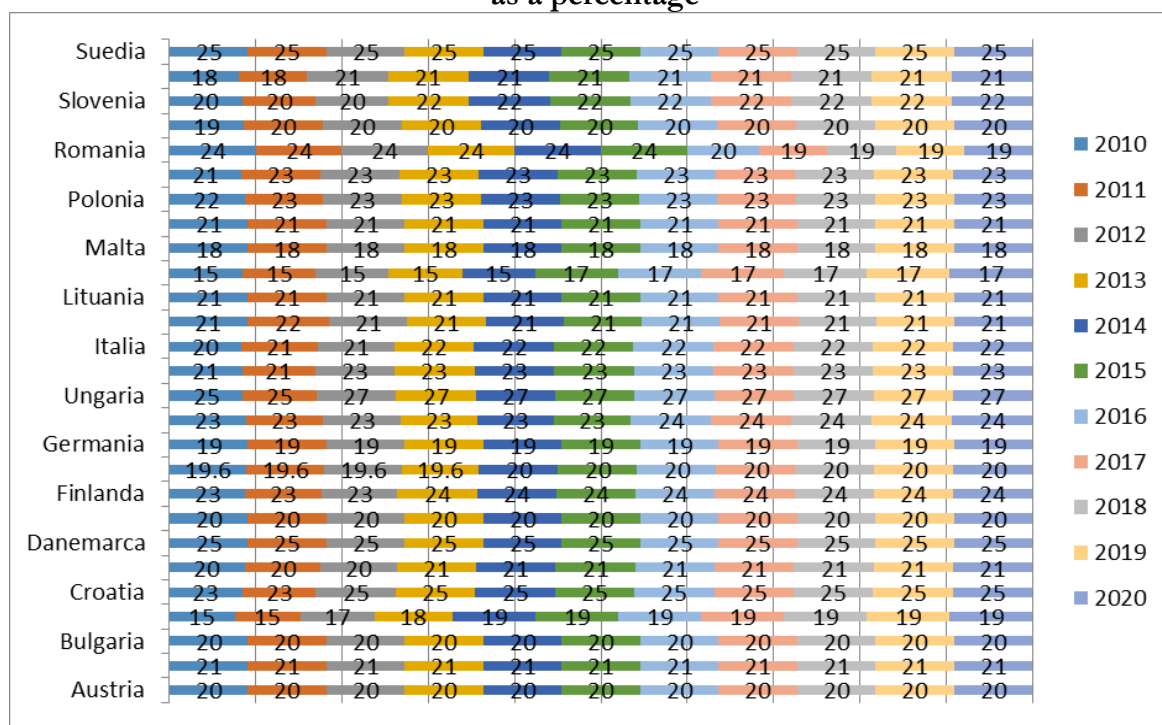
France's gap was 8%, except for the period 2015-2016, when the tax fell to 22.5%, a decrease of 18.5% compared to 2010, and in 2017 the increase was 26.5%, reaching at 49%. Latvia and Luxembourg fluctuated by 6.4%, decreasing from 25% to 23% and then increasing

to 31.4% - respectively 6.8% - starting with a slight decrease from 42% to 41.3% in 2011-2014, reaching 48.8% in 2017, later decreasing to 45.8%, as it is today.

Spain has increased by 7% from 2011 to 2012, from 45% to 52%, after which, since 2016, it has returned to the percentage of 45% that it still maintained today. At opposite poles are Finland and Sweden, which recorded an increase of 11% in the 10 years, respectively a decrease of 24.5%. Thus, Finland recorded an increase in income tax from 49% in 2010 to 54.2% in 2016, then decreased to 53.8% in 2018 and 2019, reaching 60% in 2020. Sweden, on the other hand, after a constant level of 56.5% and 57% in 2013, in 2020 fell to 32%, by 24.5%.

VAT is the main indirect tax (along with excise duties) or consumption tax. VAT has eliminated almost all other consumption taxes (Toader, 2013). When making a transaction, the tax is paid on the value of the good / service that is the subject of that transaction. Figure no. 5 presents the evolution of VAT for the 27 EU member states.

Figure no. 5 Evolution of VAT in EU member states over the last 11 years, expressed as a percentage



Source: <https://ec.europa.eu/eurostat/web/government-finance-statistics/excessive-deficit/supplementary-tables-financial-crisis>, accessed on 20.03.2021

The level of this tax is between 17% of GDP (Malta) and 27% of GDP (Hungary) in 2020. Western European countries did not change their VAT rate during the analyzed period, Austria maintained its share of 20%, Belgium 21 %, Denmark 25%, France almost 20%, Germany 19%, Malta 18%, Netherlands 21%, Sweden 25%.

All other countries had an increasing trend of this tax, all except Romania which recorded a decrease from 24% in 2010 to 19% today. Countries like Bulgaria have kept their VAT rate constant in the 10 years analyzed at 20%, Estonia 20%, Lithuania 21%, aligning in this respect with the above countries. The highest tax is found in Hungary, which in 2010 and

2011 was 25%, and since 2012 remained at 27%. In the other countries there were increases of 1-2 percentage points, and the trend was generally upward, not fluctuating as in the case of other indicators.

2. Budget deficit

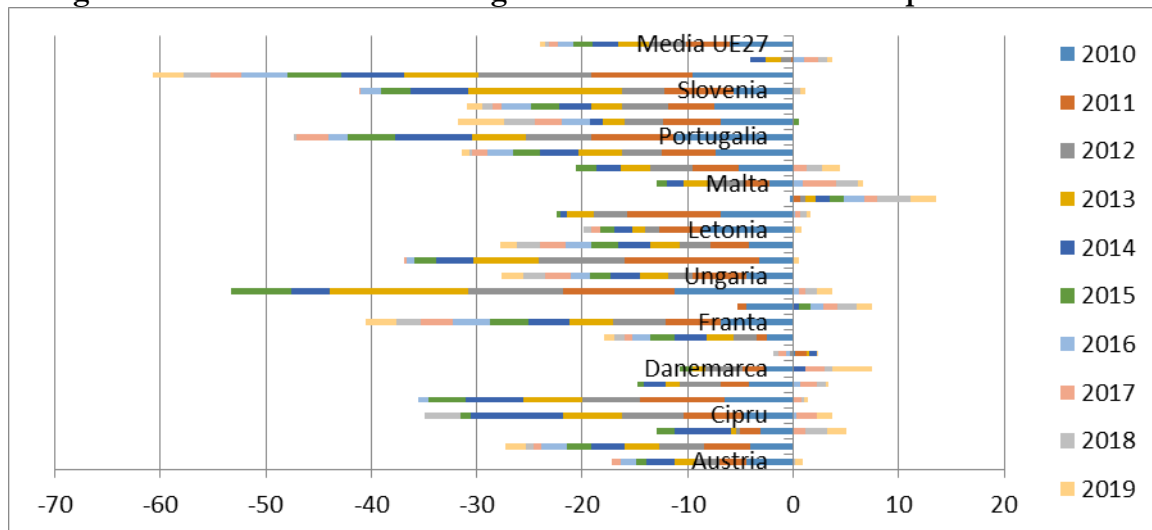
The budget deficit is a macroeconomic indicator in which expenditures exceed revenues from taxes or other types of revenues, which do not include loans.

2.1. The advantage of the budget deficit and its evolution

The budget deficit is not necessarily a negative thing when it is fully reflected in investment and infrastructure spending and is covered by secure financial resources, without resorting to inflationary monetary issues. But when the budget deficit arises, states are forced to spend more, which requires the introduction of additional money supply, which is not a market demand - and so inflation occurs. It is expressed as a percentage of the Gross Domestic Product. Figure no. 6 is a graphic presentation of the evolution of the budget deficit for the 27 EU member states.

If in 2010 all 27 member states of the European Union had a budget deficit, in 2019 only 9 (33%) of them still reported a deficit. And if in 2010 the largest deficit was registered by Portugal (-11% of GDP), which managed to counterbalance the indicator up to 0.1% of GDP by 2019, in 2019 Romania is the country with the highest level of budget deficit from the EU, with a value of -4.4% of GDP. However, we must specify that Romania also registered a decrease of the deficit from -6.9% of GDP by 2.5 percentage points.

Figure no.6 Evolution of the Budget Deficit in the EU 27 in the period 2010-2019



Source: https://ec.europa.eu/eurostat/databrowser/view/GOV_10DD_EDPT1_custom_603631/default/table?lang=en accessed on 23.02.2021

Regarding the **influence of fiscal policy** on the deficit, it should be noted that the countries with developed economies in the EU do not have major fluctuations in the deficit as neither the revenue-generating elements of the analysis underwent major changes during the 10 years analyzed.

In **Austria**, income tax, corporate tax and VAT - which we will call **VENPROTVA** - had the same values in the 10 years (50% - 55%, 25% and 20%), and the deficit decreased from -4, 4% of GDP in 2010 to 0.7% of GDP in 2019, steadily declining without fluctuations. The

5% increase in income tax in 2016 did not increase the deficit, but on the contrary, it continued its downward trend.

The decrease in the deficit in **Belgium** registered 2.2 points, given that both VAT and income tax had the same values of 21% and 33%, and the profit tax decreased by 4 percent in 2018 and 2019, years in which the deficit recorded the lowest values. **Bulgaria** has aligned itself with the rule of Western states by not changing **VENPROTVA's** tax rates in the 10 years, achieving a 5% reduction in the deficit, given that it has the lowest tax rates in the EU.

Cyprus did not change the income tax (35%) but the profit tax increased by 2.5% in 2012, after which it remained constant, and VAT increased by 2 points in 2012, then 1% in 2013 and another 1% in 2014. The year 2014 registered the largest deficit of -8.8%, decreasing by 7.9% in 2015, under the same values of **VENPROTVA**.

Croatia decreased its deficit by 6.9% in 2019 compared to 2010 and by 8.4% compared to 2011. The VAT rate increased by 2% in 2012, the corporate tax remained constant at 20% and the income tax decreased by 3% since 2017. The 10-year analysis shows a decrease in the deficit when tax cuts took place. In 2012 the deficit decreased by 2.2%, and in 2017 by 1.6%. However, at the same time it should be mentioned that the decrease of the deficit has been constant since 2011, still registering higher values in the mentioned years (2011 and 2017).

The Czech Republic recorded a decrease of 4.5 points amid a 7% increase in income tax in 2012 and a 1% increase in the VAT rate. The corporate tax remained constant at 19%, and the deficit started to decrease from 2012 when the income tax increased until 2018. In 2019 there is a slight depreciation of 0.6%, given that **VENPROTVA** remained unchanged.

Denmark registered a decrease of the deficit by 6.5% in the conditions of the decrease of the profit tax by 3 percent, and the income tax had a slight increase of 0.5%, the VAT remaining constant. The largest decrease in the deficit took place in 2019, a year in which **VENPROTVA** remained constant.

Estonia got where it left off, that is, in 2010 the deficit was 0.2% and in 2019 0.1%, but fluctuating. The corporate tax was reduced by 5% in 2015 and the income tax by 1% also in 2015. From the analysis of the budget deficit data, in **Estonia** it is observed that from 2016 the deficit starts to increase, reaching only in 2019 the level of 2015, leading to the conclusion, together with the above analysis, that these indicators have little influence on the level of the deficit.

Finland saw an increase in income tax by 11% in the years under review, but a corporate tax fell by 6% and VAT increased by only one percentage point in 2013.

The deficit decreased by **1.5%** in 10 years, but did not have a constant evolution. In 2014, the corporate tax decreased by 4%, which coincides with the largest deficit, and in 2015, the income tax increased by 3.3%, which is reflected in the decrease of the deficit by 0.6% and 1.7% in 2017, a percentage that we also find when increasing the income tax. Finland is the first country in the analysis so far to show a direct link between deficit reduction and tax increases.

France decreased its deficit by 3.9%, with a constant evolution of decrease (less in 2019 when it increased by 0.7%). The profit tax had major fluctuations, an increase of up to 10% (2017 compared to 2010), the income tax was also fluctuating, registering decreases of 22.5% (that is 50% in 2015 and 2016 compared to 2014). VAT increased by only 0.6% since 2014. These reductions did not change the deficit in 2015 and 2016, registering the same values of -3.6% with an improvement of only 0.3%. In 2017 it decreased by 0.6%, and in 2018 when the corporate tax decreased by 10%, the deficit decreased by 0.7%. So the increase or

decrease of taxes led in any case to the decrease of the deficit, hence the conclusion of an indirect relationship between the 2 variables.

Germany, with a steady improvement in the deficit of 5.9% (less in 2019 when it decreased by 0.3%), had the same level of taxes in the 10 years. The corporate tax has increased by 1% since 2016, but given that the deficit has decreased until that year, this increase is not significant. Therefore, the deficit level is not inflated **VENPROTVA**.

Greece had the largest deficit recovery of 12.5%. It is true that in 2010 it also recorded the highest level of deficit in the EU. The maximum share of income tax had low fluctuations, decreased by 3% in 2012, 2013 and 2014, then returned to 45% in 2015, and only in 2019 decreased by another percentage. The corporate tax is at the same level at the end of the analyzed interval, this indicator had a sinuous evolution, decreasing by 4% in 2011 and 2012, then increased by 6% in the next 2 years, then by another 4% in the next 4 years, and in 2019 it decreased to the initial level of 24%.

VAT has been constantly evolving, increasing by only one percentage point since 2016. The large gap between the values of the deficit in the conditions of relatively small changes of the analyzed indicators leads to the conclusion that they have little influence on the variation of the deficit.

Hungary maintains its negative deficit at similar values. Income tax decreased by only one percent in 10 years, from 16% to 15% in 2016, in 2017 corporate tax decreased by 10%, constant VAT in 2012 with a share of 27% (the highest in the EU). In 2017 there is a slight increase in the deficit by 0.6% and we can find a link of direct proportionality with the decrease of the profit tax.

Ireland, had a strong increase in 2011 compared to 2010 by 9.6%, subsequently, the deficit decreasing annually, reaching positive values in 2019, recovering 13.3% from 2011 to 2019. This development was not determined by the change of **VENPROTVA**, as only VAT increased by 2 percent in 2012, then had the same level.

In **Latvia**, the deficit decreased by 8%, the largest decrease of 5.8% in 2012, after which the deficit decreased steadily but with low values. The income tax decreased by 2% until 2017, after which it increased by 8.4%, also in 2018 and the corporate tax increased by 5%, after a constant level in 2010-2017, and the VAT decreased by 1 % since 2012, then constant level. The deficit in 2018 was at the same level as in 2017, before the tax increase, which shows, again, that it is not directly influenced by **VENPROTVA**.

Lithuania has a similar evolution to that of Latvia, the deficit decreasing by 7.2%, given that both the corporate tax and VAT were constant. Income tax increased by 5% in 2018, the deficit difference between 2017 and 2018 being only 0.1% in the sense of increase, here there is the possibility that it will be influenced by the increase in income tax, although if we compare with the situations encountered in other countries, the decrease is unlikely to be due to the increase in income tax.

Luxembourg is the only country in the EU that has positive values in all years (less 2010 when budget expenditures were 0.3% higher than revenues).

Income tax increased by 2% from 2010 to 2016, in 2017 by another 4.8%, after which it stabilized 3% lower in the next 3 years. The corporate tax decreased by 3% in 2010-2020, by a percentage in 2015, 2017, 2018 since it remained constant, and VAT increased by 2% in 2015, remaining at the same level.

In 2017, when the income tax was maximum, the deficit increased by 0.6% compared to 2016, recovering in 2018 when it had the highest value of 3.1%, but not due to **VENPROTVA**.

Malta had a positive evolution of the indicator of 5.5% from 2010 to 2017, then decreasing by 2.7% until 2009. According to official websites, the values of the **VENPROTVA** indicators have been constant over the 10 years, the evolution of the deficit not being influenced by it.

The Netherlands had a steady evolution in terms of growth, with 6.9%. This state also had the same taxes in the analyzed interval, with a slight decrease of the income tax of 0.2% and 2.5% in the last 2 years of the analyzed interval. There is no direct link between the deficit and **VENPROTVA**.

In **Poland**, the only change in taxes is by 1% VAT in 2011 compared to 2010, the deficit increasing by 6.7% in the analyzed period.

Portugal reduced its deficit by 11.1%, in the conditions of the increase by 1.5% of the income tax, the profit tax had evolutions in the sense of increase → decrease → growth, by 3% another 3% in 2012, constant level until 2015, a decrease of 2% until 2018 and then an increase of another 2% until 2020. VAT increased by 2% in 2011 compared to 2010, the level being then constant. The deficit decreased from 2010 to 2013, in 2014 it increased by 2.3%, after which it decreased again until 2019, its evolution not having a direct connection with **VENPROTVA**.

Romania registers the highest level of deficit in 2019 in the EU. It had a decreasing evolution from 2010 to 2015 inclusive, after which it started to grow again. The income tax decreased from 16% to 10% in 2018, the corporate tax remained constant, and the VAT decreased in 2016 by 4%, and from 2017 until now by another 1%. Given the evolution of the **VENPROTVA** indicators and comparing it with the deficit values, there is no direct link between them.

Slovakia followed the European deficit reduction trend by 6.1%. With an increase in corporate tax of 6% in 2013, an increase in corporate tax by 4% in 2013, then a decrease of 1% in 2014 and 1% in 2017, an increase in the VAT rate of only 1% in 2011 - does not reflect the change deficit as a result of these fluctuations. However, given that in 2013, the year of the increase in income tax by 6%, the deficit decreased by 1.5% compared to 2012, it can be said that there is an influence in this result.

Spain - after a slight depreciation of the deficit until 2012, then the trend was to decrease it by 6.6% compared to 2010 and by 7.8% compared to 2012. Income tax increased by 7% in 2012 compared to 2010, in 2014 it decreased by 5% and in 2016 by another 2%, reaching the level of 2010. The corporate tax decreased by 2% in 2015 and then by another 3% from 2016, and the VAT increased by 3% in 2012, since then having the same level. It is curious, a situation encountered in other states, that in the year of 7% increase in income tax in 2012 the deficit also reached the highest level of -10.7%. However, since 2016 its value has been at the level of 2010, the deficit halving and continuing the downward trend. The 5% decrease in the corporate tax did not deepen the deficit, on the contrary.

Sweden does not register too large variations of the deficit, until 2014 the deficit being negative, in 2015, as in 2010 the expenditures were balanced by revenues, and from 2016 the deficit was positive, with a slight decreasing trend in 2018 and 2019. The tax on income registered an increase of 0.5% in 2013, since then remaining at the same level, in 2013 the corporate tax decreased by 4%, in 2019 by another 1%, and VAT did not change. The 4% decrease of 2013 of the corporate tax may have influenced the deficit which increased by 0.4% compared to 2013, but with the same level of **VENPROTVA** indicators, the deficit continued to decrease.

In conclusion, it can be said that the influence of these taxes, income tax, corporate tax and VAT - **VENPROTVA**, is minor, the level of the deficit being influenced by a multitude of factors and contexts.

However, given that all these taxes represent revenues in the state budgets, revenues that have a direct link to the budget deficit, it can be said that in order to obtain a correct result, the factor of budget expenditures that is the other important component of the deficit must be analyzed.

If in emerging countries the level of taxes influences a better collection (still), and fiscal facilities influence this indicator, in countries with developed economies, which at the same level of taxes had a lower deficit, there is the problem of reducing budget expenditures in order to obtain, with the same measures, different results.

2.2. Disadvantages of the budget deficit

On the other hand, budget deficits have been challenged by many economists over time due to their negative effect on private sector lending, distorting interest rates, benefiting non-competitive firms and increasing the influence of non-market players. However, budget deficits have remained popular since they were legitimized by Keynes in 1930. However, Keynes's goal was to address deficits only in times of recession, and then as the economy begins to recover, these deficits to be corrected. However, this is not the case as rising taxes and reduced government facilities and programs are not popular even in times of economic growth. The trend has been to increase deficits year after year, reaching large public debts.

Partisans of the neoclassical school are supporters of the budgetary balance, of the lack of deficit but also of the budget surplus that turns into public expenditures, that is state interventions. "State loans have negative effects because, on the one hand, it artificially increases the budget, and on the other hand, it influences future generations" (Hoanță, 2000). Within this school, V. Pareto is a follower of the *theory of the economic optimum* which represents "that position of balance, from which starting, it is impossible to improve the situation of one without diminishing the welfare of another or others". The Pareto optimality is still the basis of decisions specific to public budgets (Toader, 2013).

Keynes and Beveridge (Onofrei, 2000) are the founders of the **theory of the systematic budget deficit**, which in fact argues that decisions should be made only out of "the need to respect certain priorities, of economic and social policy" and not on the basis of financial principles, such as budget balancing.

Partisans of this theory argue that the budget deficit is a condition for ensuring economic balance. Increasing public spending and reducing budget revenues - as an effect of tax cuts - aims to increase demand from the population while increasing investment by entrepreneurs. The budget deficit considers that it must be covered by state loans, while attracting liquidity from the population in order to finance productive objectives that would create jobs and increase production. This increases tax revenues, which will gradually lead to a decrease and then the disappearance of public deficits.

However, the context in which Keynes legitimized them almost 100 years ago has changed radically, but they are nevertheless more current than ever. However, efforts are being made to reduce and stagnate them at certain levels, especially in the European Union, which, through the Stability and Growth Pact, imposes certain limits on member countries in order to strengthen fiscal and budgetary discipline in the Member States. The main reason behind the European Union's efforts to maintain discipline and stability is that a budget crisis in one Member State could cause problems for the other Member States.

In conclusion, the deficits are seen in a negative light. While partisans of the Keynesian school argue that deficits are sometimes needed to stimulate the demand mechanism when monetary policy has proved ineffective, other economists argue that deficits restrict lending and distort the market. Also they suggest that today's loans ask for future increased taxes, which puts pressure on future generations. If larger budget deficits become politically unprofitable, the process of consolidating deficit constraints may make sense.

States can sustain their deficits to the extent that they have the capacity to obtain new loans. Credible governments can opt for increased deficits in the crisis stages, without worrying. Otherwise, it can reach the level estimated by creditors as dangerous, at which point prohibitive interest rates can be granted or loans can be stopped. The more corrupt a government is, the more restrictive the conditions for granting loans are, corruption being strongly correlated with the country rating that influences lending costs (Alesina et al., 2008).

3. The correlation between fiscal policy and budget deficit

Fiscal policy, based on the public budget, respectively budget revenues and expenditures, can influence the evolution of the national economy. The study conducted by the World Bank with Price Waterhouse Couper -Paying Taxes 2008- states that the main factor influencing the degree of compliance of taxpayers is the number of taxes and duties (The World Bank, 2008). A simplified tax system, together with reduced tax rates (Niculeasa, 2009), also contributes to increasing voluntary compliance.

In order to reduce the deficit, the “friendly” fiscal policy must focus on reducing direct taxes and contributions, increasing indirect taxes (VAT, excise duties), property taxes, but also broadening the tax base.

The reduction of the deficit also consists in decreasing public expenditures, not only by better managing public sector wage expenditures, increasing the sustainability of the pension system, but by allocating resources to expenditures that stimulate the 3 engines of long-term economic growth: increasing investment, stimulating research and development and investing in human capital (by providing professional training, but also by providing health insurance and social assistance).

4. History of fiscal policy measures and their effect on the budget deficit

Fiscal policy plays the most important role in reducing the budget deficit. Stiglitz et al. (2006) supports the adoption of a procyclical fiscal policy in times of recession - characterized by low tax revenues and rising budget expenditures, which are matched by growing budget deficits - governments should devise programs to reduce taxes and increase expenditures (but this is where public resources come in, if such measures really exist).

In opposition to this is the anticyclical policy (countercyclical), according to the specialty literature, which is specific to periods of economic “boom”, periods that are characterized by easy access to resources, offering debtors (including in this category and the state as an entity), the possibility of excessive lending.

According to Alesina, Tabellini and Campante (Alesina et al., 2008), in „boom” economic times, most economists believe that the level of discretionary public taxes and spending, as a proportion of GDP, should remain constant during a fiscal year. If governments follow these recommendations, then a countercyclical pattern can be seen in fiscal policies. Specifically, during periods of economic “boom”, public spending as part of GDP should decrease; with a constant level of taxes and a certain level of progressivity, public revenues, as part of GDP, should increase; therefore, the budget surplus as part of GDP

should increase - the effect being to consolidate through tax cuts in recession and increase them during periods of economic boom.

In practice, however, in many economically developed countries, fiscal policy is in fact pro-cyclical. In particular, government spending, as a percentage of GDP, increases during periods of economic boom and decreases in the economic recession.

The question then is why most countries are apparently pursuing fiscal policies that lead to macroeconomic instability? One answer would be to turn to credit. In difficult times, most countries cannot borrow, or if they do, the interest rate would be very high, so the deficit would increase and they would have to cut spending; in the economic boom, governments can borrow much more easily - and choose to do so - but increase public spending.

From the point of view of the above-mentioned authors, this argument is incomplete, as it raises 2 questions, namely:

- Why these countries do not secure themselves by accumulating reserves in times of economic growth, so as not to run into credit constraints in times of recession
- And, secondly, why creditors do not provide the necessary funds to governments, even in recession, as long as they are convinced that loans will help overcome the crisis.

The answer to both questions must take into account the **political arena**.

Talvi and Vegh (2005) argue that the existence of a surplus of financial resources increases the tendency of governments to spend. Alesina et al. (2008) complete the initial research, focusing on how political distortion interacts with different economic structures (in particular with income variability).

Torner and Lane (1999) believe that the more resources available (in the economic boom), the more problems they generate, and the struggle over common resources intensifies, leading to a budget deficit. Which, empirically speaking, is absolutely possible.

Alesina et al.(2008) consider that voters are dealing with corrupt governments that redirect some of the revenue from taxes paid by taxpayers to unproductive public spending - that is political rent. These rents can be considered as direct allocations (thefts) of officials from collected taxes, but at the same time favors paid for special interests, such as public employees or "friends" of the government officials.

Voters can replace the government that abuses the powers with which it was invested, but even so, these political rents cannot be reduced to zero. This problem interacts with the lack of information of the voters: they can observe the state of the economy, but they do not observe the degree of indebtedness of the government. For example, governments can accumulate non-public debt. Therefore, when voters see the economy growing, they demand more facilities for themselves (in terms of lower taxes and / or better, better quality public services). This forces governments to give fiscal policy a pro-cyclical character and therefore to borrow too much. Thus, pro-cyclical fiscal policy (increasing public spending during the boom and excessive government borrowing) appears at the request of voters. But voters do not demand irrational policies.

5. Conclusions

The main purpose of fiscal policy is to ensure economic growth and counteract the economic recession, and this is done by using the tools at its disposal → taxes and duties, which generate revenue but also allow permanent control of public spending.



The analysis shows that proponents of classical theories were not supporters of the budget deficit, but with the deepening recession in the 1930s, Keynes launched a new theory based on increasing government spending and lowering taxes to stimulate demand and thus take the economy out of recession. Keynes and Beveridge (Onofrei, 2000) founded the theory of the systematic budget deficit → which considers the budget deficit to be a condition for ensuring economic balance and covering deficits through government borrowing to facilitate investment and thus create new jobs (in the context in which the Great Depression of 1930 was characterized by rising unemployment).

However, the founders of this theory stated that this mechanism should be applied only during economic crises, until the exit from the recession, after which it should be revised. Contemporary reality shows us that this way of functioning of modern economies is preserved not only in times of economic crisis, but also in times of economic boom, as the political factor, in the desire to attract electoral capital, tends to expand populist policies and it is not willing to cut spending and raise taxes. Firms bear fiscal deficits if they know they will receive benefits from the budget, and voters do not consider these deficits to be so bad as long as they can demand quality services and lower taxes.

While proponents of Keynesian theory argue that deficits may be beneficial in stimulating the demand mechanism, other economists argue that deficits restrict lending and distort the market.

The loans requested by the government to fuel the deficits lead to an increase in the reference interest rate → thus loans will be more expensive and difficult to access for the private sector → will result in reduced investments. The solution could be the redistribution of budget revenues to investments and not the financing of investments only from loans.

The main factor that influences the degree of compliance of the taxpayer is the "number of taxes and duties". In order to be effective, the emphasis should be on reducing direct taxes and contributions and increasing indirect taxes, property taxes and broadening the tax base.

At the same time, in periods of recession characterized by large deficits, pro-cyclical fiscal policies characterized by low fiscal revenues and increased budget expenditures should be adopted. On the other hand, in times of economic boom, countercyclical policies characterized by increased taxes and possibly reduced spending should be adopted.

Taxation should not be high, it should not be perceived as a burden, as it could contribute to discouraging business interest, the growth of the underground economy. According to Mirrless's theory of optimal taxation, which states that "the optimal tax is a system of mandatory levies that maximizes tax revenues, minimizing the efforts of taxpayers." Governments should find that optimal variant of fiscal policy, specific to each country, that leads to the best ratio between sources and resources.

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