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Fiscal Policy in the Context of the Economic Crisis

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ABSTRACT

This paper tries to briefly analyze the characteristics of fiscal policy in the context of the actual crisis. We start from the ongoing discussion regarding the role of fiscal policy during the economic and financial crisis. We then focus on the case of CEE countries and on Romanian economy and analyze the way fiscal policy affects economies in the crisis context and its capacities to boost economy.

Keywords: Fiscal policy, economic crisis, monetary policy, Euro area, debt sustainability.
JEL code: E32, E62, H62.

1.Introduction

The ongoing financial crisis that started during 2008 was compared in intensity with the Great Depression from 1930's and was considered in the 2009 Economic Outlook report, the Organization for Economic Co-operation and Development (OECD) as "the most severe and synchronized" downturn in post-war history (they forecast a negative GDP growth - 4.3 % in OECD in 2009 (World wide fiscal stimulus, 2009).

Although it was initially located in the US economy, it rapidly extended to the global economy, affecting both developed and emerging economies. The specialists that analyzed this cycle proposed the idea that there is a complexity of factors behind it, like the limits of current technologies suggesting the last phase of a Kondratieff cycles (Dobrescu, 2008), and some specific factors: the excessive risks in the financial markets, the lack of sustainability in the macroeconomic policies that led to serious disequilibria.

The transmission channels of the crisis toward the national economies were mainly of a monetary nature (like the channels of prices of assets, the credit channel, the exchange rate channel, etc). This nature of the transmission of shocks affected in a serious manner the confidence of the economic agents in the financial system and destabilized the credibility of the macroeconomic policies.

The financial crisis reiterated the debate regarding the efficiency of monetary and financial policy during the crisis period and moreover their coordination in order to achieve economic stabilization. A large literature focused on the interaction between monetary and fiscal policy in stabilizing the economy, considering that in our time, the efficiency of monetary policy and the automatic fiscal stabilizers may be insufficient and, in those circumstances, the fiscal policy must be in the first line and the policymakers need to use fiscal stimulus to help the economy.

The paper is organized in six parts. After a short introduction, in the second part we try to reveal the general theoretical aspects of conducting the monetary and fiscal policy in the crisis period with the accent of advantage and disadvantage of such policies. The second section is focused on the lessons for fiscal policy. In the third we evaluate possible fiscal measures and some experience of CEE countries in conducting the fiscal policy. The fourth part is focused on the Romanian experience during the crisis and presents the fiscal policies in this context and how Romanian economies reacted to those measures. We finally discuss some conclusions in the last section.

2. General theoretical aspects regarding the fiscal policy

Actually economic-financial crisis swelled the theoretical debate about the role of monetary and fiscal policy in stabilizing the economy and diminish the negative impact of the crisis on people and firms. The new debate started with the recent paper of Romer and Bernstein (2009), which estimates the effects of a set of measure, proposed for American economy in order to create until 2010 between 3-4 million jobs. They also analyzed how could be used different types of fiscal measure (tax cut and increased expenditure in infrastructure) to achieving that goal, taking into consideration the timing effect and the financial efforts estimated over the $775billion[1]. In Appendix 1 they presented the particular multipliers for and increased in government purchase of 1% of GDP and a decreased in taxes of 1% GDP based on Federal Reserve's Bank model and a model of the private firm.

The questions that are in the core of debate are focus on: i) fiscal expansion may work in simple textbook theory, and often fails in reality ii) how efficient is fiscal policy as a stabilization tool; iii) what set of fiscal stimulus are more efficient as a countercyclical tools; iv) in the crisis period, is monetary policy able to boost economy in the absence of the additional fiscal stimulus, other

[1] The Stimulus Low approved on February 17, 2009 stipulate a final amount of $787billion.

than automatic stabilizing fiscal stimulus? v) is fiscal policy able to stabilize the business cycle? vi) when fiscal policies become essential, and so on.

Based on macroeconomic schools theory, the debates are between the economists who are the advocate of government action as countercyclical fiscal policy (Romer and Bernstein, 2009, Elmendorf and Furman, 2008, Summers, Feldstein, 2008) and the others who believe that the fiscal policy must be limited to have its main countercyclical impact only throw the automatic stabilizers (Taylor 2002, 2009, Eichenbaum, 1997, Feldstein 2002, Cogan, Tobias, Taylor, Wieland, 2009, Wieland 2008, Kraay and Servén, 2008). Taking into consideration the traditional Keynesian framework, for the short-term objective, the fiscal policy is responsible for the stabilization of the business cycle. In the European countries, especial in the European Monetary Union (EMU), the fiscal policy has also an important role in smoothing the idiosyncratic demand shocks and short term stabilization efforts.

The debate is based on the progress in the development of economic theory from Keynes' General Theory to the New Keynesian theory, from closed economies to open economies, from macroeconomic fundaments to macro and microeconomic fundaments, accompanied by the developing of the macroeconomic models that could explain the evolution of economies in our days.

Analyzing the effects of discretionary fiscal policy on the short run, Beetsma (2008) presented that, the magnitude and the directions of this effects on macroeconomic variable such output, consumption, investment, unemployment, trade balance and real exchange rate differs if we modeling that impact using a closed economic models or an open economic models and depend of the set of the fiscal instrument used. The different results of the analyzing maybe, could explain the difficulties for the wide consensus of the economist regarding this topic.

Kraay and Servén (2008) conclude, in their paper regarding fiscal response to the current financial crisis, that the fiscal countercyclical discretionary measure succeeds rarely and could generate perverse effects, difficult to reverse as unsustainable dept accumulation and high volatility among others, and strongly recommended to avoid such measure on short or long term.

Cogan, Tobias, Taylor, Wieland, (2009) in their paper about Romer, Bernstein (2009) evaluation of the fiscal stimulus proposed in US in 2009, expressed a similar opinion. They pointed not only the influence of the theoretical fundament on the directions and magnitude of the effects, but also the importance of the econometric aspects of methodologies applied, especial robustness that is a crucial criterion required by policy evaluation and theoretical fundaments of the model. So, Cogan, Tobias, Taylor, Wieland argued that the results obtained by Romer, Bernstein are influenced by the assumption under the old Keynesian framework, without the rational expectation, and the result could be different under the New Keynesian Model that have forward looking or rational expectations by individual firms, and some forms of price rigidities, as the Smets-Wouters (2007) model for the US.

First problem discussed by Cogan, Tobias, Taylor, Wieland (2009) was regarding the paging interest rate around zero, as assumption for monetary policy, which is in contradiction with New Keynesian model because of negative economic consequence (rise inflation), and as Sargent and Wallace (1975) pointed lead to instability because the inflation expectation of firms and household become unanchored and the price could exploded. To keep interest rate at paging level would be difficult under the condition of permanent increase of government expenditure, that usually push the inflation rate up to hyperinflation.

Regarding the fiscal aspects, Cogan, Tobias, Taylor, Wieland (2009) highlights: on the one side, the multipliers effect, considering on their simulations that impact of permanent increased of government spending could be smaller, with a decreasing tendency and, on the other side, that the fiscal stimulus are a mixture of increased transfer payments (as entitlement payment for unemployment compensation, health and welfare benefits), tax refunds and higher government purchase that will affect different the path of fiscal deficit as compare to path of government purchase and, under the rational expectations, the firms and households will anticipate that the deficit would be financed by increasing taxes and so, the stimulus effect would be smaller than Romer, Bernstein projections or possible negative in the first year based on crowed effect on consumption and investment. The Cogan, Tobias, Taylor, Wieland (2009, p.16) explanations are: "taking into consideration that the tax rebates and transfers to the individuals are temporary, permanent income theory, even in the presence of liquidity effects, says that the impact on consumption and thereby aggregate demand will be small…. Although there is a great deal of uncertainty, a review of literature over the years suggests that the marginal propensity to consume for such tax and transfer payments is at most 0,3%, though it will depend on timing, expectations and other factors. Recent aggregates evidence suggests that it may be much smaller".

Many studies (including the survey studies) about the efficiency of tax rebate in the stimulus of the spending, and stabilized of the economies revealed that a rational consumer should not raise his or her spending very much in response to one time rebate that does not significantly increased lifetime income, but the households are a good deal more responsive to shift in income than theoretical models focused on lifetime income suggest, event that the magnitude of consumption response and the nature response to different sort of income tax change are very different (Elmendorf, Furman, 2008). So, the result of the Shapiro and Slemrod work (2008) regarding the contribution of the tax rebate to stimulate expenditure on the US after the George W. Bush Recovery Rebates and Economic Stimulus for the American People Act of 2008, highlights that the people used the money to save or paid the debt, and only 1/5 of the respondents of the survey spend the money, so the propensity to spending was low. This result is in line with the other studies (Shapiro and Slemrod, 2003 on 2001 tax rebate and Coronado, Lupton Sheiner, 2005, on the 2003 child credit rebate), according to the households spend 25% of their rebate in the short run. Agarwal, Lin and Souleles (2007) find, based on card analysis, that household used a part of the rebate to pay down the credit card balance and, after that, for increasing their spending. Regarding the fiscal stimulus on the economic agents, the survey studies show that the impact is limited (only 10% of business said that bonus depreciation was important factor in their investment decision, as Cohen, Cummins, 2006) different from other studies (Hose and Shapiro, 2006) that find a positive effect, but "the timing of the estimated effect did not line up well with theoretical prediction and the maximum effect occurred after three years" (Elmendorf and Furman, 2008, p15).

Regarding the increase the government expenditure on new infrastructure, as a fiscal stimulus in the crisis period had a little impact on the short run because require years of planning and preparation and, more worse, project that could be undertaken more quickly (Veldhuis, Lammam and Palacios,2009).

Talking about the fiscal support of American economy, Jeffrey Sachs (2009, cited in US Senate Republican Policy Committee, p.1), considered that "without a sound medium-term fiscal framework, the stimulus package can easily do more harm than good, since the prospect of trillion-dollar plus deficits as far as the eye can see will weigh heavily on the confidence of consumers and businesses, and thereby undermine even the short-term benefits of the stimulus package."

Bernanke (cited by V Wieland, 2008, p.11), referring to the Fiscal Stimulus in US in 2008, considered that, "fiscal stimulus, if protracted, badly targeted and too late, will not help support economic activity in the near term, and could be actively destabilizing if it comes at a timer when growth is already improving".

Those aspects pointed by Sachs (2009) and Bernanke (2008) are very important for efficiency of the fiscal stimulus and derive from the principle that must be taken into consideration when the policymakers decided to use fiscal stimulus in order to boost the economy. The economists' debate regarding the principals of fiscal and monetary policy revealed the importance of some criteria like transparency and credibility for the monetary policy and endorsed a series of principals for the fiscal policy: i) **timely**, that means to use the fiscal stimulus at the right time, not prematurely, not delay to long, kipping in mind the time needed for implemented some fiscal stimulus like tax cut or increase spending; ii) **targeted**, which means that every money from fiscal stimulus will contribute to the maximum output raises in the short run; iii) **temporary**, which means that fiscal measure would be on the short run, and not affect the budget deficit in the long run. Taylor (2008) referring to that principle considers first, that the permanent stimulus must be preferred to temporal ones; second, that taxes targeting is an other important principle and third, that predictability of fiscal stimulus must be considered. He added that, increasing taxes in a period of crisis generates an increase in the unemployment, and consequently a weaker economy, and that the principal of predictability means that the firms and households can anchor their expectations.

Taking into account these considerations, we can mention that, during the crisis period, the difficulties become more evident. The predictability of the fiscal stimulus impact on the macroeconomic variables depends on the tip of the model used, on the accuracy of the date and, even more, on the abilities to outshine the uncertainty strengthen by the actual crisis.

Through debates on advantages and disadvantages of fiscal and monetary policies in stabilizing the economy, especially during periods of crisis, it is necessary to take into account, according to the opinions of economists, the following aspects:

- Time needed to implement and then achieve the desired effects; practice has shown that, while monetary institutions need a short time in implementing policies, and the responses due to those changes follow almost immediately, for fiscal ones, time is much longer for implementing decisions, and the reactions occur with a delay (lag) that cannot be neglected.
- Level of intervention to achieve the desired effects. How much should one reduce taxes and increase spending for output to grow? From experience, during crisis, families receiving financial support from government will not use that support to increase spending but rather to pay debts and make savings. By comparison, a reduction of interest rate, a loose monetary policy, can stimulate investment.
- The range of measures that are short term should not influence the size of the deficit on long term, given that, along the above-mentioned conditions, an increase of deficit will draw an increase on future taxes, which in the end will explain the retention to spend.

For policymakers is important to know when fiscal policies become essential. There are some opinions (Elmendorf and Furman, 2008) that consider the fiscal stimulus are important in addition to monetary policy when the interest rate of Federal Reserve are close to zero, when the policymakers want to achieve a lower unemployment rate with higher interest rate rather than lover interest rate and, when the monetary policy become inefficient to boost economy.

Economic literature point out when the fiscal policy could become the first driver for stabilizing economy:

- When interest rate is very low, near to zero, and other instruments will be needed to construct monetary policy;
- When monetary policy starts to lose its effectiveness in sustaining economic activity, despite the reduction of interest rate on the money market, the demand for credit is low;
- An important role, is the reduction of spread among different interest rates; in this case, the pessimism itself is damaging the economy, that makes all monetary stimuli ineffective;
- When full employment is needed with high rates, rather than low rates. At present, full employment is required at low rates. When an expansionist monetary policy leads to low interest rates then the output increases, and when deficit grows the effect will be in raising interest rates;

- When same additional market conditions take place: currency depreciation as a result of low interest rate, is an important tool through which monetary policy help economy; low interest rates support demand for housing and their funding; low interest rates help investment and economic growth in the long term.

3. Lessons from the recent crisis for fiscal policies

A rich literature was devoted to the analysis of the current financial and economic crisis and to the measures that can limit its effects both at global, regional and national level, including fiscal policy. The most efficient solutions seem to be found in a mix of prudential and regulation policies promoted at a global and a national level (IMF, 2009, a, b).

Blanchard,(2009,p4), lists the conditions that underlined the current crisis "the underestimation of risk contained in newly issued assets; the opacity of the derived securities on the balance sheets of financial institutions; the connectedness between financial institutions, both within and across countries; and, finally, the high leverage of the financial system as a whole" and "two amplification mechanisms behind the crisis… first, the sale of assets to satisfy liquidity runs by investors; and, second, the sale of assets to reestablish capital ratios".

Starting from these facts, the fiscal policies have served as an important instrument to ensure the necessary liquidity to the functioning of the financial system through massive government funds injections and to isolate the toxic actives through the state acquisition in order to block the mechanisms that could amplify the crisis. According to Blanchard (2009, p. 19), the dimension of the crisis required coordination measures for the all involved national economies, as simple unilateral decisions of "protecting domestic depositors and investors at the expense of foreign depositors and investors can create the risk of major outflows from depositors and investors in similar situations elsewhere, and the risk of similar measures by other countries".

The six lessons for the fiscal policy derive from the recent crisis, synthesized by the experts of IMF (2009,c) are presented further.

1.Beside the fact that the fiscal policy did not a major role in the recent crises, the global imbalances were materialized through a huge U.S. current account deficit that increased the systemic risk. Large fiscal deficit, change the investor's behavior and determine a massive outflow of capital in the U.S., which in return causes distorted adjustments, including the value of dollar. Lending mechanism is a crucial factor in strengthening the dollar and reducing the systemic risk. Low interest rates and massive inputs of capital in the U.S. and Europe are a result of the imbalance in the CIS. Two factors have influenced these developments: the mechanism of increased credit and the creation of risky assets. Increase of systemic risk can reverse the trend of economic growth, and the expansion of prudential regulation cannot prevent all associated risks. Hence, those who are in charge should pay more attention to the price movement of assets, loan growth, loan mechanism, and to the increase of systemic risk. The main issue here, is identifying these elements and react in due time in order to prevent them. In particular, the effects of systemic risk depend on the sophistication of the financial system, and even more if growth is associated with weak mechanisms of loan; therefore the explosion has a limited impact on assets. What is important is that this crisis has deeply affected the price of assets, which further reflected on the balance sheets of different units within the financial sector.

2. Fiscal policy plays a major role in the unfolding crisis. While many governments have exploited the economic growth by reducing government deficits and debt over the stipulated level, the solvency was not among the concerns of governments, and then the crisis began in the private sector. After that, the crisis revealed two sides. First, the budget deficit was not reduced sufficiently during the period of economic growth, when state revenues were high, hence limiting the fiscal maneuver space imposed by measures of crisis management. Second, is related to tax system in most countries, where the system is dependent upon the deductibility of debt financing interest payments. These fluctuations increase along the loans mechanisms (high interest rates) and thus increasing the vulnerability in the case of shocks originating within the private sector, generating political difficulties that must be eliminated.

3.Other conclusion of IMF experts (2009, c, p.14) is that "fiscal policy can help contain speculative episode and make easier to deal with their aftermath". What is very important in this case is, on the one hand, to establish the fiscal buffer as a rule to prevent the situation when the assets price increased and could cover a unsustainable fiscal position and, one the other side, at the aggregate level, to moderate the booms and to diminished the "vulnerabilities by lowering demand pressure".

4. Tax distortions like mortgage interest deductibility or similar tax provisions favoring housing borrowing, the deductibility against corporation tax of interest payment can encourage high leverage and are not recommended to the policymakers.

5. The complexity of the taxation on assets price dynamic, the tax provisions that could affect the level, growth and volatility of key assets, kipping in mind the great impact of valuation of some assets on balance sheets of financial system, highlight that the best fiscal measures are those that have a neutral effect across the different types of assets and income combine with uniform countercyclical tax measures.

6. Actual crisis show the necessity to explore the potential of other taxes, less studied like the potential role of aggressive tax planning, proper treatment of tax losses and tax impact on risk-taking by the economic agents and household.

Those lessons are complete with other derived from analysis about actual crisis realized by Kraay and Servén (2008, p.2) who consider that the past experience show the pro-cyclical character of fiscal policy, adding that in developing countries, this character arise from "weakness of automatic stabilizers and the pro-cyclical bias of discretionary policies" and "reflects underling fundamental challenges" of those countries. The type of fiscal policy (increase spending or cut tax) must be adjusted from county to country and in the case of increase spending, it is important to choose the "areas where the expenditures are either reversible or likely to increase growth in the future" as infrastructure. In this respect, Barro (cited in Ensign, Thiessen, 2009, p.3) consider that " on the spending side, the main point is what we should not be considering massive public works programs that do not pass muster from the perspective of cost-benefit analysis". The necessary financing for countercyclical fiscal policies would be ensuring by multilateral bank and institutions agreements in order to support the sound policies to the developing countries or those that ask for financial assistance.

Credibility of fiscal expansion is very important and differs from county to county. So, Martin Baily consider that "it would be easy for Russia to be credible in announcing inflationary policy but hard for Japan" and Krugman pointed the importance of sustainability mention that "the economic question is whether the fiscal expansion would have an unacceptable impact on the government long term fiscal position (cited by Seidman, 2009, p2). The importance of fiscal sustainability for macroeconomic stability and growth are pointed also on the G 20 Communiqué Meeting of Ministers and Governors São Paulo Brazil, 8-9 November 2008.

According to the principle of timing, fiscal intervention must be take in place timely but without rushed only when the institution involve in such measure have finish their preparations (have approval for expansions spending for new projects or new legislation regarding the tax cut, etc).

Taking about fiscal policy as intervention tools for the European countries Krugman (2009, p.1) pointing that the coordination of the fiscal policy is even more important:" we're rapidly heading toward a world in which monetary policy has little or no traction: T-bill rates in the US are already zero, and near-zero rate will prevail in the euro zone quite soon. Fiscal policy is all that's left. But in Europe it's very hard to do a fiscal expansion unless it's coordinated"; and he continues to explain why, in his opinion the coordination is very important for Europe: "The reason is that the European economy is so integrated: European countries on average spend around a quarter of their GDP on imports from each other. Since imports tend to rise or fall faster than GDP during a business cycle, this probably means that something like 40 percent of any change in final demand "leaks" across borders within Europe. As a result, the multiplier on fiscal policy within any given European country is much less than the multiplier on a coordinated fiscal expansion. And that in turn means that the tradeoff between deficits and supporting the economy in a time of trouble is much less favorable for any one European country than for Europe as a whole".

Marinheriro (2005) referring to the fiscal policy in the euro area, highlight the contribution of the government sector in smoothing the more persistent shocks to output, especially in the small countries affected by a negative asymmetric demand shocks that could not be influenced by monetary instruments used on the European Central Bank.

One can conclude on the importance of political reaction to the serious external imbalances through macroeconomic policies that stimulate investment and savings, and the potential positive role of prudential measures to reduce systemic risk associated with a massive input of capital by imposing national constraints against exposure to exchange risk of national institutions and all other borrowers.

4. Aspects of fiscal policy in the context of current economic crises. Experience of the CEE countries

The actual crisis had a strong evidence of the necessity of the coordination of the policy measure in order to diminish the impact of financial crises on the economies not only at the national or regional level, but also at the global level. For the European countries, the coordinated policy measures in order to maximize the positive cross border impact was realized in the context of the Stability and Growth Pact that ensure the economic and budgetary background and reinforce the need for solidarity among the 27 Member State and the Lisbon Strategies that target the long term objective of building a competitive and sustainable EU economy. On December 2009 European Council put in place a European Economic Recovery Plan (EERP) in order to set the step in dealing with crisis on the EU Member Stat. The main goal of this plan was to reform financial sector (especially focusing on regulation and supervision regime) and to reinforce the confidence in the financial sector, to review the measure that could sustain the demand, boost the investment and retain or create job. The other objective of EERP was to limit the hardship for individuals and prevent the loss of precious skills. At the same times, the Member State should implement the own Economic Recovery Plans based on the social and economic difference of every countries and the estimate impact on the crisis in order to limit the negative effects. The coordination between the regional and national plan is essential because the of the positive cross border effect of the national action sustain the demand for good and services in other Member State and the financial support (Community Medium Term Financial Assistance) offered by European Union for the Member State that could confront with liquidity problems in their own financial systems.

A very important aspects is that all the measure for recovery real economy implemented by the Member State must following eight principle: maintaining openness within the internal market; ensuring non-discrimination by treaty goods and services; targeting intervention towards the long term policy goals; recognizing the importance of the SMEs; maximizing the overall positive impact by sharing the best practice; using the synergies effects among the Member State; return to the government deficit position consistent with sustainable fiscal position as soon as possible; keeping the Single Market open to EU trade partners and respect the international commitments.

The fiscal policy, play a major role in the EERP under the restrictions of the Maastricht criteria that targeted the fiscal deficit to 3% of GDP an total debt to 60% of GDP and would take face with the declining in the tax revenues and increased on social benefits as effects of economic weakness on the one side, and the need for fiscal stimulus (well timely, targeted and temporary), on the other side, in order to boost the demand and promote resilience in the short term, in the selected areas of the Lisbon Strategy. That explain, what, even in the crisis period, the state that face with high fiscal deficits (Romania, Malta, Poland and Lithuania) was notified by the Commission that are under the excessive deficit procedure (EDP). The Commission prepare an report with recommendation to end the excessive deficit situation in order to achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one off and temporary measure, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation" (Art.3(4) of Council Regulation EC N1467/97).

What it is very important is how the fiscal policy will work in the EU Members State in order to restrict the negative impact of the crisis and how big will be the fiscal support? The Commission of the European Communities COM(2009) 114 presented the "Driving European Recovery " recommendation under the coordinating EERP, establish the aria of fiscal intervention and dimensions of fiscal support. Some directions of the intervention could be highlight, fiscal policy being involve in the economic recovery and alleviating the human cost of the crisis.

Regarding the fiscal policy support for the growth and jobs across EU, according to EERP, during the 2009-2010, its level is targeted to 3.3% of GDP (more than 400 Billion Euro). The great part of this support will come from automatic stabilizers and 1.2% of GDP will come from discretionary fiscal stimulus packages of the Member State, in accordance with the dimension of the individual fiscals maneuvers rooms of the countries. From EU sources, 0.3% of GDP equivalent of 30 Billion Euro would be made available. The investment in new energy and high speed Internet in rural communities is targeted at 5 Billion Euro and the additional payment under cohesion policy is targeted at 11 Billion Euro (7 Billion Euro will be only for the new Member State). The financial support of 15 Billion Euro for SME lending will be provided through European Investment Bank in order to help its activities to improve competitive base. For the Member States that are in the process of reducing their budget deficit and their dependence on external flows of credit was initiate a fiscal support to facility for the medium term assistance to the balance of payments of non euro area like Hungary, Latvia and Romania.

The forecasting of crisis impact on the labor market show that employment could be contract in 2009 by 1.6% and that the unemployment could reach 10% in 2010, so the current European Social Funds program support 9 million worker each year, and the amount for 2009 is 10.8 billion Euro in Grants. Taking into consideration that huge impact and in order to prevent the loss of precious skills, the recommendation for Member State statues four broad types of priorities:

i) maintaining existing job by short time working allowances, reduced social securities contributions, wage subsidies and support to SMEs;

ii) ensure rapid re-integration into the labor market by vocational training and support for disadvantages, changes in sickness or disability benefits and new eligibility rules for unemployment benefits;

iii) support the most vulnerable people by increasing the minimum income/wage, extend coverage or duration of unemployment benefits, higher housing or family allowances, tax rebates or exemptions, and measures against over-indebtedness or repossession;

iv) strengthen social protection and invest in the social and health infrastructure by investment in housing, hospitals, primary care, long term care infrastructure and schools and actions to help pension funds meet their long term liabilities.

These recommendations which are in line with fiscal principle and are consistent with long term fiscal sustainability and provide support for long term investment policies are adapted from country to country based on specific condition of the crisis impact.

Romania, as new Member Stat of European Union taking into consideration this general recommendations establish own measures for sustain economic growth and protect jobs and avoid fiscal deterioration of the financial sector activities, starting with measures agreed in the medium-term financial assistance in the area of fiscal governance and long-term sustainability of public finances.

So, as a preventive measure to ensure the confidence in the financial system, in the context of a high current account deficit, and major reserves of foreign currency for the National Bank (NBR), the Romanian government asked for a foreign credit line totaling 19.9 billion euro, from which 9 billion euro from IMF, 5 billion euro from European Union, 1 billon euro from the World Bank, BERD and European Investments Bank, combined with 1 billion from international financial corporations. The first part, of 4.9 billion euro was already sent in May 2009, after the approval of the Stand-By Agreement with Romania by the IMF board.

With respect to this issue, Ghosh, Chamon, Crowe, Kim, and Ostry (2009, p.13) mentioned :" In response to the current crisis, Romania has attempted to avoid complications that could arise from high foreign ownership of domestic banks by actively seeking support for recapitalization from their parent banks in the context of an IMF-supported program".

Isărescu (2009), the NBR Governor, mentioned that the need of the external credit was generated by the dependence of the Romanian banking system, predominantly formed from foreign banks (88%, according to Lazea, 2009, p. 4), external financing (58% from total, Lazea 2009, p. 4) and net bank external debt very high (20% of GDP, according to Lazea 2009, p.4), by the strong impact of credit on economy and the deterioration of the exchange rate.

Additional measures were taken by NBR in order to prevent the impact of the crisis, among which Lazea (2009, p.5) mentioned: i) meeting in Vienna with the nine most important foreign banks, under the IMF SBA: a model to be replicated by other countries and meeting in Athens with the seven Greek Banks present in Romania, in order to maintain/roll-over a higher percentage of the net bank external debt; ii) stress-testing all the banks that have at least 1% of the market, plus selected smaller banks and requiring the banks to eventually bring in new capital in order to have a CAR of at least 10%, in order to prevent/minimize defaults on forex credit that could trigger wider consequences; iii) NBR is mandate to changes in the management/ownership of banks, if not satisfied with their compliance.

Romanian Package of measures to support economic growth and limiting the effects of crisis was approved at the Government Session on January 29, 2009, containing three lines of actions: A. Measure for reviving and stimulating economic growth, B. Measures for financing the economy and increasing liquidity, C. Social measures as in Appendix 1. Additional measure (A1, B1 and C1) on each direction of action were proposed and subsequently approved, with the sole purpose of completing the package of initially approved measures. The amount of the financial support of these measures is presented in Appendix 1.

Analyzing these measures we can see that more than 6% of the fiscal stimulus is linked with infrastructure investment, which is equivalent of 20% of the budget expenditure on 2009 that implied a strong effort in order to prepare the investment program, and time to crossing the legal administrative steps. In order to reduce the time needed for preparing the infrastructure investment, in the Government Program for the period 2009-2012, some change in the legal framework regarding the ways and conditions for participating to the bids for transport infrastructure works was take in place, by eliminating the “lowest price wins” principle that was proven as damaging, and by introducing the compliance with the partial deadlines as condition of unilaterally termination of contract.

In order to boost economy, some discretionary measure take in place as the export subsidies, the subsidies for fertilizers for the farmers, non-taxation of reinvested profits; exemption of tax on reinvested profits will lead to the creation of new jobs and the support for the SMEs.

On the demand side improve measure we can mention the Rabla Program which stimulates the demand for new cars and the First House Program that offer the State guaranties for the bank credit under the minimum conditions impose by this Program.

Great parts of the measure try to support the most vulnerable people, especial retired person and unemployment by increased the income and the duration of the unemployment allowance even if the late measure could discourage the people to look for another job, or to integrate into the retraining vocational programs.

What is very important is the fact that these measure are in the context of the IMF Stand by Arrangement, focus on the reversing the deterioration fiscal path (in 2008 the fiscal deficit reach on 5.1% of GDP) with significant expenditure cuts and additional revenues, so in 2011 to come back under the 3% of GDP.

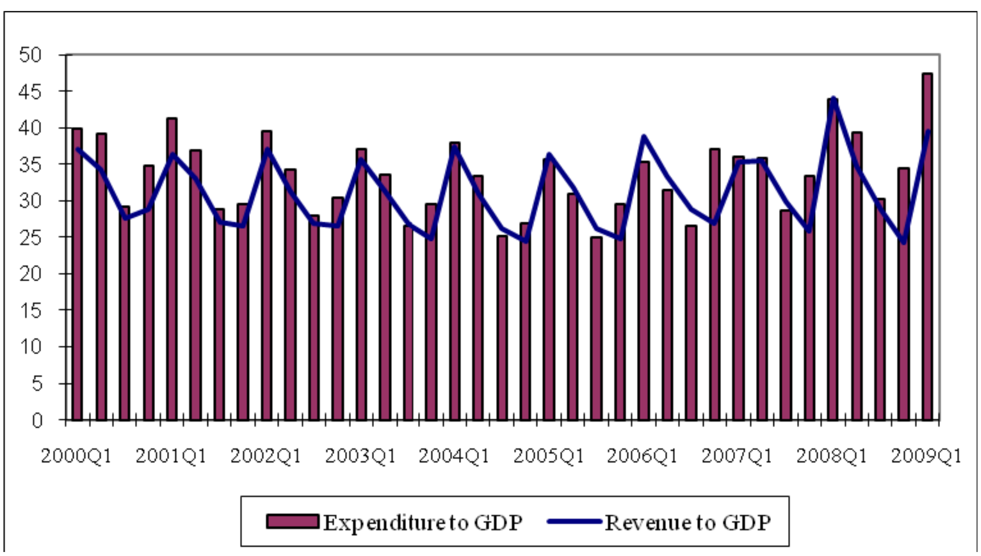
It is too soon to accounting the effects of these fiscal measures on the Romanian economy so we concentrate on the impact of fiscal policy during the 2000-2009 in order to determine how real economy reacts to the fiscal stimulus.

5. The impact of fiscal policy in Romania

In order to highlight the impact of fiscal policy in Romania we will concentrate our analysis on 2000-2009 period.

The expenditure and revenue as percent of GDP during the Q1 2000-Q12009 show a great volatility during the year with a tendency to decrease the revenue and increased the expenditure in the last quarter of the year, tendencies accentuated after 2005 that show a weak governance of Romanian finance (Figure 1). The pattern of the revenue as percentage of GDP, well below the level of the expenditure in the first quarters of the years explain the great number of the revising budget process in the Romanian economy in order to harmonizing budgetary parameters with the developments of macroeconomic indicators and a strong recommendation from IMF experts to improve the fiscal management by increasing fiscal expertise and capacities at all government level, modifying the rule and procedures that underpin the present short term orientation.

Figure 1 Consolidated budget revenue and expenditure as percentage of the GDP



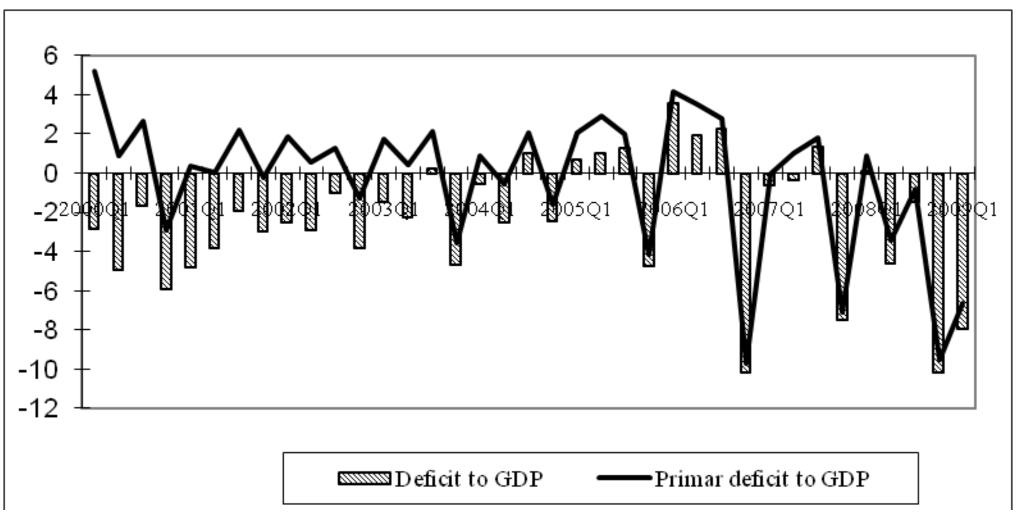
Source: INSSE data; starting the 2006, according to the new classification are included also the UE grants and own revenue.

The evolutions of the revenue were influenced by the two major fiscal reforms:

- in the early of 2000 year was implemented, as main tax adjustments, the introduction of personal income tax, the reduction of the profit tax from 38 percent to 25 percent (5 percent on exports), the introduction of a uniform VAT rate of 19 percent and the removal of most tax incentives and tax exemptions;
- in the 2005 year was implemented new measures consist of the cut in profit tax from 25 percent to 16 percent and the introduction of flat tax rate of 16 percent on income tax that boost additional the consumer demand and contribute to the overheated Romanian economy; the state social security pension, was also a subject to regular indexation and the implementation of a new realignment stage.

After integration into the European Union the efforts to control the government expenditure slow down and the fiscal deficit increased to an unsustainable level on the 2008, influenced by the strong electoral cycles and popular measures to increase the pensions and wages, and continued on the first quarter of 2009 (Figure 2).

Figure 2 Deficit and primary deficit of the consolidated budget as percent of GDP

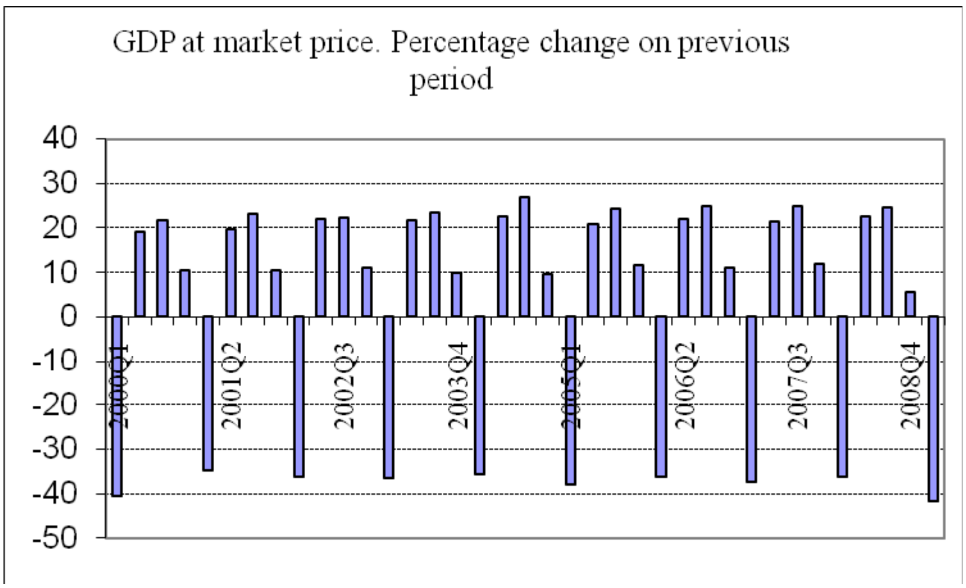


Source: Date from INSSE

Those explains way in May 2009 the Romania was notified by the European Commission that are under the EDP and must adopt the strong measure to come back the deficit under the 3% target. Except a very short period, the deficit on GDP registered negative levels that situated under the target during 2001-2006 when the Romanian Government take attention to achieve the Maastricht criteria in order to be the Member of the European Union. The deficit pattern for 2007 is unusual because after three quarter with positive level the deficit registered –10.14% of total GDP, which are a measure of inconsistent management of fiscal resource allocation with a deteriorated tendency on election year 2008. Also these results are linked with the 3-4 rectifications of the budget during a year, with a massive spending accumulating in the last quarter. The primary deficit as percent of GDP show an increased of the expenditure with accumulated dept that increased the interest payment and the effect of exchange rate movements on the budget spending.

Comparing the deficit pattern with the GDP growth as compare the previous period (Figure 3) we can see that Q1 2009 is characterized by a great contraction on the activity, the GDP growth registered all the period the negative levels as effects of the cyclic activities and the seasonal aspects.

Figure 3 The GDP growth as percentage change on the previous period



Source: Data INSSE

As Socol and Socol (2009, p245) conclude for 1999-Q2 2008 “the Romanian fiscal policy was mostly inconsistent, pro-cyclic and weakly anchored on a medium and a long term. The low budgetary transparency, the divergent spending of the public money, the lack of feasible projects proposed for financing by the government, the poor quality of the public officers’ competence, the absence of priorities in the budgetary expenses and of the strategic vision regarding the management of the public finances have represented the main threats to the efficiency of the fiscal policy in Romania”.

6. Conclusion

The current financial and economic crisis is a challenge for the profession of economists. Not only that it proved to be unpredicted but it challenged the core assumptions of economic theory as well as economic policy.

For the new member states that aspire to join the Euro Area the challenge is even bigger as they struggle to ensure a sound recovery without endangering the criteria that are necessary for joining the Euro Area. One potential of problem could come from the debt sustainability of these countries.

The near future will show how much the conventional thought in terms of fiscal and monetary policy is helpful and how much the policy makers should look for unconventional policy measures. Some of the countries might even choose to reduce their fiscal rates, in order to attract new investors.

As for the case of Romania, the economic realities show that the government is far from having applied the best economic policies. In the context of a recession that continues to persist, while most of the European countries emerge from the recession, Romania should drastically reevaluate its fiscal policy.

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Appendix 1

Social and Economic Measures and the financial efforts of the Romanian package measure to support economic growth and limited the negative effects of the crises

No	Measures	Value	Percent of GDP
1.	Allocation of about 10 billion euro, representing 20% of budgetary expenditures in 2009 for investment in infrastructure; our priorities include transport infrastructure, rehabilitation of thermal housing, health, education, environment, rural development and tourism;	-38,32 bilion RON	-6,62
2.	Payment of government debt, outstanding invoices and grants;	-8,4 bilion RON	-1,39
3.	Government's zero priority: improving the mechanism of fund absorption. In its first meeting from 2009, the Government decided the establishment of the Interdepartmental Committee to manage absorption of EU funds under the direct leadership of Prime Minister and its Deputy;		
4.	Non-taxation of reinvested profits; exemption of tax on reinvested profits will lead to the creation of new jobs, creation of new SMEs and to stimulate appetite for investment at firms that were not yet into this; also, tax relief on reinvested profit will contribute significantly to increasing the state budget under conditions in which the VAT and income from tax aggregates better than tax on profits;	-3,44 bilion RON	-0,59
5.	Compensation of recoverable VAT with payable VAT or other taxes due to state budget, and in the following months after the month in which the application for refund was lodged, and after the legal deadline of 45 days;		
6.	Capitalization of CEC Bank and Eximbank, the two banks will receive an capital injection in order to support small and medium enterprises; Draft measures against crisis provides Eximbank capitalization and public fund allotting to insure export operations, such as currency risk and the risk of non payment;	- 900 milion RON - 170 milion RON	-0,16 -0,03
7	Establishment of the Romanian Fund of Counter-Guaranteed Credits for SMEs, which will increase up to four times the value of the actual Guarantee Fund. Also, within CEC structures a fund for financing small and medium enterprise will be constituted;	- 400 milion RON	-0,07
8.	Allocation through the state budget, of the same allocated volume of funds for promotion of exports in 2008, and increase the state contribution to fund this activity;	-21 milion RON	-0,004

9.	Continuing and expanding the Rabla(Junk) program – from 2009, cars older than 10 years are accepted as well, two years "younger" than those admitted to last year. The new program brings innovations along with the increase of the amount granted from 3000 to 3800 RON, and financing of at least 60,000 vehicles compared to only 40,000 in 2008;	-200 milion RON	-0,03
10.	Financing the purchase of chemical fertilizer for subsidizing farmers;	-2,4 bilion RON	-0,41
11	The program first House introduce the State guaranties for the credit for the new house buy by the credit from banks		
12.	Inclusion in the general consolidated budget of revenues provided by institutions and government agencies.		
13.	For retired people with low income, for the entire duration of the crisis we will cover the difference form the current level of pension, up to 350 RON made in two installment, 300 RON since May 2009 and 350 RON, since October; the main social categories targeted by this measure are retired people from farming;		
14.	Offsetting by 90% of the reference prices of drugs from the B list. This is intended for retired people with pensions of less than 600 RON, which at the same time represents the minimum wage on economy; The compensation will be made for up to 100 RON per person, per month. The amounts required will be allocated from the withdrawal fee without interfering with CNAS's allocated budget for compensated drugs;		
15.	Handling of income during technical unemployment: in terms of employer - as income of non-wage nature and applying the appropriate tax methods; in terms of employee: the exemption from payment of contributions to the state budget and social security;	-100 milion RON	-0,02
16.	Support by 50% for continuing vocational training for employees and unemployed.	-13 milion RON	-0,002

Source: Romanian Government