INTERDEPENDENCIES BETWEEN ROMANIAN FISCAL POLICIES AND INFLATIONARY TENSIONS IN THE CURRENT EUROPE

Prof. dr. Marcel DRĂCEA
Mădălin CINCĂ, PhD Student
University of Craiova

The nature of fiscal policy has important consequences on how the monetary policies are built because monetary policy has consequences on budgetary solvency in terms of fiscal policy data, so that any change in monetary policy requires change, to some extent correlated, and in politics tax.

Experience shows that Member developed an increased inflation does not rise to increased production. At the same time, inflation disposal costs high. If inflation in the years 1950-1960 is situated at a fairly low level, it has grown stronger in the years 1970-1980, and then in 1990 to fall to a level of 1-3%.

It was found that an increased inflation as recorded in the 1980s did not generate an increase in production. This conclusion has proven valid in Romania during the post-recorded decreases of increased industrial production and significant increases in the inflation rate. Even if in certain periods there was a nominal increase of industrial output in real terms the situation was completely different.

In the years 1990-1993 fall of the economy and increase inflation in an accelerated pace contributed to a large extent on a strong decrease in the level of gross domestic product of Romania. During the same period, the government of Romania has taken some measures of fiscal policy through the exemption of tax on profits of companies depending on the activity that has stimulated the offer in periods when GDP had an average annual pace of growth contained between 3.9% and 7%.

A great influence on inflation and had an introduction of value added tax on consumption. Immediately after the Emergency Ordinance nr.3/1992, which set a single VAT rate of 18% without the option for zero inflation by the end of 1993 was the biggest in the 1990-2005 period, namely 295% measure and has led to increased minimum wage to 144%.

Since 1995 introduced reduced VAT rate of 9% for certain agricultural products and foodstuffs, and in 1996 expanded the reduced rate of 9% and on other categories of products, reducing inflation to a level of 27.8% in 1995, and 56.9% in the next year, compared to 61.7% in 1994 and 295% in 1993.

The introduction of the flat 16% which remained valid until now has had the effect of a gradual decline, almost linear, inflation, currently it is below the limit of 10%, namely 9% in 2005, 6.56 % In 2006, 4.84% in 2007, a revised estimate in August 2008 to 6.6%, although in early Releases forecast 3.8% and the 2009 estimate is very optimistic, only 3.5%. On the other hand, the National Commission for Prognosis has provided the following estimates for price developments:

	2008	2009	2010	2011	2012	2013
%	5,8%	4,5%	3,5%	3,0%	2,6%	2,3%

Romania faces, with the accession to the European Union, with a phenomenon of the increase in prices similar to that recorded in countries that joined in 2004, according to the existence of risk factors that act in the direction of stopping the disinflation.

The timing and magnitude of price adjustments administered, and changes in fiscal policy that will take place in the next period, are risk factors, from the perspective of the impact on inflation.

Thus, during 2008 took place in November adjustments of regulated prices, especially in the electricity, heat and gas, which will retrieve the costs of housing and, implicitly, the consumer price index, the conditions under which revised timetable to increase the price by regulators.

The price of natural gas production would be aligned to the import by the end of 2008, whereas until early 2007 took place instead liberalization of electricity market, with partial liberalization of the price of heat and the need to reference rate nationally.

Consider that another factor that affected the evolution of inflation when Romania joins the European Union has been a harmonization of tax legislation with the acquis communautaire in respect of duty. In the field of harmonized excise duty, from 1 January 2007, increases were made to the main groups of products subject to this regime, up to the minimum amounts required (to lead gasoline, fuel oil, electricity). At the same time, excise duty will be extended to other products (natural gas used as fuel for heating in the commercial and noncommercial).

States that joined the EU in 2004 have recorded significant increases of prices, which were partially alleviated in 2005. Thus, in integration, only three of the ten new Member States, consumer prices have advanced at a rate lower compared with the previous year, in Slovenia, Slovakia and Cyprus. The highest inflation rates were recorded in Latvia (up from 2.9% to 6.2%), Poland (from 0.8% to 3.5%), Czech Republic (from 0.1% to 2.8%), Lithuania (from -1.2% to 1.2%) and Hungary (from 4.7% to 6.8%).

The main causes, which have served to increase the rate of inflation in countries that have recently joined the European Union, were:

- increase in prices of foodstuffs;
- increase prices on alcoholic beverages and tobacco, due line of duty;
- supplement expenditure on health;
- harmonization of tax legislation with the acquis communautaire in respect of indirect taxes: VAT, customs duties, excise duties.

Also, increasing prices for housing maintenance, gas and electricity have accelerated inflationary process. On the other hand, chances are high that import prices have exerted a favorable influence on the internal rate of exchange fixed or appreciation of national currencies as fundamental instruments to control inflation. In the case of new member countries, enlargement and represented the beginning of a period of growth, based mainly on intensifying domestic demand and attract investment.

According to the Committee for Economic Forecasting, in support of the disinflation process could help a budget policy that by carrying out the rhythm of spending, targeted particularly to targets productive, could lead to deficits in balance and to increase labor productivity - the default growth.

In contrast, growth expectations over the price of international crude oil and natural gas, especially in terms of tensions in the Middle East and the war in Georgia, and prices of food could have the effect of slowing or even stopping disinflation. In Romania, food and soft drinks have a large share, representing about 40% of the consumer basket, almost double compared to the weights recorded in the Czech Republic (20%), Slovakia (17%) and Hungary (21%). Regarding maintenance of housing, share prices linked to the consumption basket, although it is relatively small compared with other countries, is the second biggest after food. Thus, any change in the prices of these groups leading index increased in total due to large weights that they hold the consumer basket.

I think it is unlikely that an average indices of the new member states to apply to Romania, especially in the case of group housing maintenance, water, electricity, gas and other fuels, where estimated values will be considerably higher. Also, it should be noted that the annual average due to the methodology of calculation is very sensitive to both the monthly distribution, and developments of the previous year.

Although annual inflation rate was around the level of 9,2-9,4% in July 2008, that level was not recorded in the past three years (July 2005) due to increases in administered prices of gas and electricity And increasing excise duty (they influence the proportion of 0.9% monthly inflation), however, the National Bank forecast remains unchanged at only 6.6%, however by 2.8% higher than estimated at the beginning of the year.

I appreciate that there is a risk of failing to achieve the inflation target for 2009, any imbalance or fluctuation major internal or external nature, even a natural disaster as happened with the floods in the summer of 2008, may compromise the inflation target. Inflation recorded a downward trend from August and by June 2009, there is a favorable base effect, which will help lower inflationary process. There may be a major risk in terms of inflation targeting in the second half of 2009, when the light is projected a fiscal relaxation.

The following will try to address the peculiarities and limitations of monetary policy and their interdependence with fiscal policies in emerging economies open and small countries in the new integrated European single, looking in particular monetary and fiscal policies in Romania, which faces a number of challenges as a result of the liberalization of capital flows. With all the changes following the integration of Romania into the European Union, the National Bank has managed to overcome these challenges, especially after the adoption of new strategies to direct inflation targeting. However, is still a need to implement a mix of appropriate macroeconomic policies that will be assisted real convergence with other European Union countries, while maintaining macroeconomic stability. At present, is a real challenge for both developed economies as well as in emerging countries, achieving long-term objective of monetary policy, namely maintaining a rate of inflation at a low and stable.

In the case of countries that have joined in the last round, central banks could face a more difficult task, namely to respond to the shock of the real and nominal, as financial markets have not yet reached that level of maturity and the degree of diversification of financial instruments with operating is still quite low. These shocks are, in general unanticipated consequence of variations in the level of prices in food, energy, maintenance and managed prices and massive capital flows, which require limitations as regards the effectiveness of monetary policy, making it even more urgent need to implement a mix of policies to take compensatory role. Without these measures and coordination with other economic policies, may appear a risk that price stability should be achieved by affecting other macroeconomic balances, which may be in some cases auto reversible. For example, it is obvious that, taking into account that held the capital entries in a volume high enough, an increase in interest rates which aim to maintain inflation at a low and stable could have the unintended consequence of the increase deficit current account.

In recent years were use three strategies standard monetary policy that results were expected in terms of providing an effective nominal anchor, and targeting monetary aggregates, targeting exchange rate and inflation targeting.

Economies of scale lower in countries such, Bulgaria, Estonia and Lithuania prefer anchor the exchange rate, and arrangements of "monetary council." Member of the rest of Central and Eastern Europe have chosen the option arrangements for exchange rate with a degree of flexibility higher, such as free floating in Poland, controlled floating Romania and the Czech Republic, or use a fluctuation band of exchange type ERM II as was adopted in Hungary, which is correlated with the objective of targeting inflation. In the framework of a "council money," monetary policy at the discretion of an "autopilot", while central banks aimed at targeting inflation in actively using methods and tools available to monetary policy and adopt complex decisions aimed at objective level of inflation low and stable.

Massive capital inputs, regardless of the monetary policy strategy adopted, brought a series of problems for monetary authorities. A number of analysts analyzes emerging Member of Central and Eastern Europe, with economies which are in a stage of development quite low, which are in front entrances of the capital on international markets, comparing them with honest citizens who live in a dangerous environment, the degree of vulnerability in the face of massive capital flows potentially reversible is very high. Reviewing developments in these countries in recent years, I appreciate that their opinion was relevant and well-founded, since on the one hand, capital inflows have role stimulating economic development, thus facilitating real convergence, thus contributing to diminishing inflationary pressures in the short term by the influence they have on exchange rate appreciation, and on the other hand, the appreciation may affect the competitiveness of foreign economies, in this way amplifying external imbalances. The effect of large external imbalances is increasing the vulnerability of the economy to changes in the plan and psychological of investors or shocks induced by a high volatility in the markets, leading to the depreciation of the currency and, ultimately, to increase inflation.

For Romania, the liberalization of the capital and adopting the strategy of targeting inflation has been put into practice at a particular time in relation to other countries in the region, but due well established. Thus, the implementation of structural reforms late in the 90s had the effect of high inflation and high levels of nominal interest rates. It also proved crucial restructuring of the entire banking system so that the financial sector to develop the capacity of resistance so that it can absorb shocks induced by massive capital inputs, a normal market without restrictions. Regarding financial sector soundness, I align the opinion of José Manuel González-Páramo who considers that financial systems are likely to increase, rather than absorb, the effect of shock resulting from the adoption of financial policies procyclically or accumulation of "excesses" in periods of strong expansion.

Last but not least, in the 90s in Romania was necessary to ensure a satisfactory level of coverage of imports by international reserves, this effect may be hardly achieve in the years 2002-2006. However, despite this delay, the liberalization of the capital could be achieved based on the following principles: entries before output flows medium and long term flows before short-term direct investments before investment portfolio and compliance with the sequence of bank-firm-population. Respecting these principles, the full liberalization of the capital account was completed several months before the accession of Romania to the European Union, being related to the establishment in 2005 the new objective of the Central Bank of direct inflation targeting.

In adopting the new monetary policy strategy were a number of reasons such as:

- a necessity of ensuring sustainability of increased disinflation;

 instability interdependence between monetary aggregates and inflation;

 risk generated by the existence of a system of exchange rate anchored to another currency, in terms of an appreciation trend caused by the progressive opening of the capital.

Since not all preconditions were met, in adopting a shorter strategy of direct inflation targeting could not achieve the rate of inflation is still at a level above 10%, and fiscal dominance, although declining, was still persistence. In addition, there were deficiencies and as regards the fact that the transmission mechanism of monetary policy actions diminish the effectiveness of monetary policy and even the ability to forecast of National Bank didn't reach the optimal level.

To discourage speculative capital inflows during the period preceding the last stages of the process of liberalizing the capital account and adopt the objective of direct targeting of inflation, the Central Bank started in November 2004 a series of measures for facilitation of the exchange rate, which is characterized by a smaller number of interventions, less predictable, both on the money market and foreign exchange. At the same time pursuing the same objective, the National Bank decreased when the situation required it, the interest rate for monetary policy and only partially sterilized excess liquidity. Despite these measures, since the market emerged a strong increase of aggregate demand, the central bank was forced to restrict strengthen monetary policy by raising rates and reserve requirements through the adoption of prudential and administrative measures. Overall, monetary policy has become more restrictive, despite reductions fairly high interest rates to monetary policy.

Policies such as administrative and supervisory measures have been adopted aimed at tightening the eligibility criteria for individuals and limiting, in the banks, the degree of exposure in case of loans in foreign currency, taking into account that delaying adoption of these measures would have the unwanted increases work at non-bank financial institutions. Nowadays, this process is the stage of completion.

In the period following our accession to the European Union in early 2007, some of these measures and have proved inefficient, because their visa application only local credit institutions, and on the other hand banks have identified a number of techniques circumvention of these restrictions. In time, the positive effects of these measures have been affected by distortions, so that the national bank decided to repeal these measures and, from that time, banks have been granted permission to operate credit on their rules of quantification risk, of course after obtaining approval from the central bank.

Despite these measures, monetary policy could not avoid the gradual current account deficit from 8.4 percent of GDP in 2004 to approximately 14 per cent of GDP in 2007. This trend reflects, to some extent, the convergence of Romania to the European Union. Relaxation of credit has allowed the expansion of private consumption is a direct effect of negative developments the current account balance, and the magnitude shadows relatively good macroeconomic performance of Romania.

Another focus of the Bank was to increase the contribution of short-term debt to finance the current account. It recorded a high dependency of private sector capital inflows of short-term, leading to increased vulnerability of the economy and a weakening of the ability to absorb shock from the international financial markets. If we look ahead, the success of the process of economic convergence with the EU Romania will be dependent on the consistency of economic policies which they adopt the Romanian authorities. I consider it very important to the economic programs, and the electoral period in which we are not to leave fingerprints on any harm to them.

In the next period will be required to start the process of adopting the euro, which requires more attention to the correlation of the main economic measures that take into account the fact that the Romanian economy needs particulars because of its economic and delay the start of reforms, for a period adjustment before the entry into ERM II, during which all the important structural reforms to be completed. This period should be seen as a chance to be able to complete the reforms initiated earlier, and in situations that can arise along the way. To ensure the progressive rate of inflation to stay within the Maastricht criteria for price stability, the National Bank will continue to pursue the goal of direct inflation targeting.

In monetary terms presented, the practice of a prudent fiscal policy will support the sustainability of public finances. I believe that maintaining a low inflation rate and stable conjunction with a solid fiscal position will contribute to bringing out the criteria for convergence in the nominal exchange rate stability and interest rates on long-term, so taking shape real possibility that Romania adopt the euro in the year 2014 as planned.

In an environment characterized by globalization, interdependence and global financial uncertainty, an ideal monetary policy should be the main features qualitative assessment, commitment, consistency dynamic avoid excessive fluctuations, transparency, responsibility and flexibility, set of attributes that involves, inevitably complex.

I appreciate that it is necessary to prioritize the evaluation qualitative where entries massive capital may have the effect of either increasing inflation or increasing current account deficit. Disinflation gains to be obtained as a result of currency appreciation substantial deficits and current account are not sustainable. In these circumstances, monetary policy can be a controversial and support from fiscal policy becomes a necessity, and as incomes policy and consider that it should be prudent and not pro-cyclical. For countries that have started the process of disinflation choosing a suitable pace of disinflation to avoid conflict with the objective of financial stability would be a more effective option. Inability to maintain financial stability can only lead to inflationary tensions.

Taking into account those outlined above, consider that the adoption of the objective of monetary targeting direct inflation should be correlated with some specific tax policy. Using administrative decisions as a substitute for lack of support from an appropriate mix of policies returns results only in the short term. Each time, as soon as possible, operators will identify ways in legislative domain to avoid administrative restrictions, so such problems will recur. There is only one viable solution: the adoption of a coherent mix of policies to support sustainable economic growth and maintain macroeconomic stability, in which an important role to play structural reforms, particularly those in the financial sector.

The process of financial globalization has a low potential to induce instability in those countries in which financial sectors are not very developed, the stronger, more consistent macroeconomic policies and trade systems more flexible. Deploying an appropriate mix of policies coordinated proves more effective than individual state policies. A restrictive monetary policy cannot offset short-term than the lack of support from the structural reforms, budgetary policy and fiscal policy revenues and the resulting situation is not the most efficient in terms of real convergence.

Fiscal-policy budget are critical in ensuring the maintenance of external imbalances to a sustainable level, the public sector must restrict the purpose of providing a larger space for maneuver of the private sector, thus avoiding the practice and conduct a procyclical. Meanwhile, revenue policy should maintain the same prudential reasons and not to send signals inadequate for determining salaries in the private sector.

For the last time Romania has made a significant reduction in the inflation rate - from more than 14 percent in 2004 to under 5 percent at the end of 2006, because in 2007 and 2008 to register a further expansion, against the backdrop of global financial crisis and growth the level of wages above productivity. We can see the influences of external factors such as increased food prices on the international market, but obviously those factors such as domestic demand overheating and rising costs of labor - have their role.

Consider that the new trend upward inflation must be fought bitterly, because the whole economy benefits from a low and stable inflation, particularly employees and pensioners with modest incomes, they are most vulnerable to amend the level of prices.

In conclusion, an effective policy involves coordinated action on both plans, monetary and fiscal. In particular, the United States, fiscal policy has a special importance because it directly controls about 40 percent of spending the whole economy. If the National Bank of Romania is left alone to fight against inflation, the result will be a strong growth rate, which will affect the share of investment in gross domestic product and thus the prospects for economic growth. Therefore, the appropriate response policies of the central bank, which may include new increases in interest rates, should be supported by a restrictive fiscal policy and wage policy in the public sector prudent, both with the objective of reducing inflation and promote economic growth.

In the previous years, monetary and fiscal policies did not come into conflict, but are in a relationship of interdependence. Therefore, both inflation and interest rates on long-term have been reduced, while capital formation as a share of gross domestic product has increased. Maintaining this favorable economic environment is the key to sustainable economic growth, lasting, which will thus lead to convergence of income levels to Western Europe.

On the other hand, fiscal and monetary policy would act against another. Concretely, in view of rising inflationary expected, during 2008 the central bank increased interest rates strong, being targeted primarily to stimulate consumption loans. Also during 2008 started a slight relaxation of fiscal policy, in addition to the increase of pensions by over 40 percent during the period November 2007 - January 2008 and by 20 percent in October 2008 and a minimum wage of about 30 percent, Is projected and a deepening of the general consolidated budget deficit for 2008 to 2.7 percent of gross domestic product.

Among the mix restrictive monetary policy - fiscal policy relaxed the conditions under which real interest rates increase continuously, the most important, unfortunately, will reduce the actual investment. Even if short-term economy would continue to grow strongly, reducing the investment will experience by reducing economic growth in the future. Capital inflows resulting from increases in interest differential will be reflected in an appreciation of leu, which in turn will support the disinflation process, but will lead to widening current account deficit as a result of reduction of exports.

REFERENCES

Isărescu, M..	Discurs la Academia Regală de Ştiinţe Economice şi Financiare din Barcelona, 21 februarie 2008

Paramo, M.	*Financial systems, new technologies and productivity growth*, Central Bank Articles, 11 iulie 2008
Rato, R.	*Sustaining Global Growth* , Madrid, 30 martie 2007
www.bnr.ro	Site oficial al Băncii Naționale a României
www.cnp.ro	Site oficial al Comisiei Naționale de Prognoză