FISCAL POLICY AND THE CONCEPTUAL MECHANISM OF FISCAL SYSTEM

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Abstract
The government, in most democratic states, has the supreme monopoly characteristic of public services, services that are realized through fiscal policy instruments, respectively through government revenues and expenditures. This research aims to provide the defining substrates of fiscal policy, so that a theoretical model of the fiscal system's functioning to can be outlined, from the perspective of the three sectors of the state, respectively: the economic, social and political plan. In order to achieve this objective, it was used as a research method, the case study of the specialized literature, being a qualitative research, meant to bring pluses in knowledge. Establishing the fiscal strategy at the level of state's political plan has direct effects on the economic plan, and, depending on the fiscal policy at the national level, there may be influences on the social plan of the country. Thus, any political choice affects the socio-economic component of the state and vice versa. The design of the taxation system can be considered an essential ingredient in public policies, as it mainly finances government spending. Based on the study, it was concluded that the use of public revenues and expenditures in order to influence the degree of the economy's development, makes fiscal policy to be considered the medicine or the drug of public finances, which can cure or worsen the existing situation.

Keywords: *fiscal policy, fiscal mechanism, fiscal system, Keynesian theory.*

JEL Classification: *E12, E62, H20*

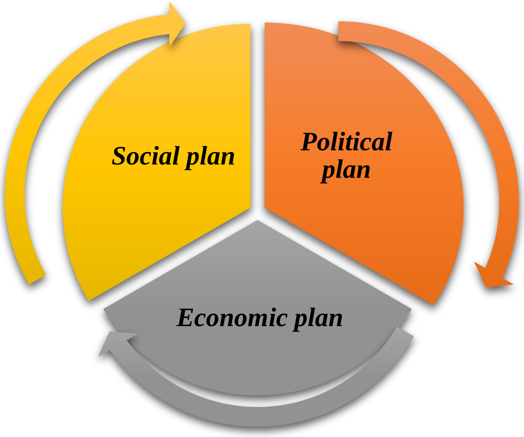
1. Introduction and context of the study

Given the fact that in society, governments never disappear, even if they provide poor quality services, and given the fact that they have a monopoly on public services, we believe that this should not stand in the way of increasing the efficiency of the state in managing the national public budget, and the primary purpose of society is the need to focus on those activities, which lead to the development of the economy and the improvement of the general well-being of citizens.

The economic development of states is a very important issue due to the economic, social and political structure of developing economies [2], and the study of the interaction between fiscal policy instruments and economic, political and social stimuli [10] , reinforces the idea that the state, as an independent entity, acts on three main interdependent sectors according to figure no. 1, which have different responsibilities, namely: the economic, political and social sector.

According to Nobel laureate, namely Leontief Wassily, *the economic plan* as a whole is a complex system, with a network of processes that depend on each other, directly or indirectly, and any process within the economic system exists only because they have place of exchange relations between them [12], for example, revenues do not make sense if there are no expenses, nor supply, if there is no demand.

Figure no. 1 Interdependence between the main sectors of society



Source: made by the authors based on the study of the literature

As the name suggests, *the political plan* refers to the organizational and political structure of the state, and *the social plan* refers to everything related to relationships, interactions between organizations and individuals, their freedoms and rights, and their defining culture.

Within each developed society there is a form of governmental organization, which may or may not represent its members of society collectively, but certainly has coercive authority over them, individually. The managing authority, central or local, has to perform functions and duties, and these obligations involve expenditures and, consequently, also require revenues. Thus, due to the existing interdependence, what happens on one sector, often has effects on the others.

2. Research methodology

This study addresses a qualitative research and uses the case study approach, which involves reviewing various articles in the literature, being a form of documentation to achieve the purpose of the research. This paper aims at the theory and practice of fiscal policy functioning at the level of society, so that the purpose of the study to be achieved, namely outlining a conceptual model of the taxation system, at the level of a state. The aim of adopting qualitative research is to develop, based on the Keynesian approach, a theoretical mechanism for the functioning of the fiscal system, so that it is possible to provide new views on the desideratum of the tax system and fiscal policy, designed to bring knowledge and to complete the current specialized literature.

This research is divided into six sections designed to achieve the main objective of this study, namely: the introductory section, which sets out the context of the research; the second section, in which the research methodology is presented; the third section, in which the literature in the analyzed field is presented; section four, which sets out fiscal policy guidelines; section five, in which the results of the research are highlighted, respectively the conceptual mechanism of functioning the fiscal system is presented, starting from the fiscal policy of the state; and, the sixth section, respectively the last section is concretized by offering the general conclusions of the present paper.

3. Literature review

The study of fiscal policy and its mechanism of operation has been developed in the literature and it has been concluded that fiscal policy is a very powerful weapon, which gives power to governments to "play with it" in the desired sense. The aim is to target in a healthy direction, from an economic point of view, so that fiscal policy to have a constructive influence and not one that endangers the economic situation [9].

Fiscal policy is an intensely studied topic in the literature, mainly by analyzing the influence of government revenues and expenditures on the economy [17] - [23], finding that economic

development can be achieved by implementing appropriate measures of a stable fiscal policies, taking into account the legislative strategies for its implementation [7]. For example, government revenue has been found to have a positive impact on long-term economic growth, while government expenditure and public debt have a negative relationship with it [13]. The study of the phases of the economic cycle, but also how fiscal policy responds to economic, social and political stimuli concluded that the departure from the premise that developed countries have a countercyclical fiscal policy, while developing countries have a pro-cyclical one it is not valid for all cases [6]. This would mean that policy-makers need to formulate fiscal policies tailored to the economic situation, leading to improvements in the economy.
Regarding Keynesian approaches, the theory of fiscal policy and how its evolution has influenced the political principles implemented so far, shows that government revenues and government expenditures were designed as a tool to support the economy, with no new role for fiscal policy [4]. Thus, in a static economy, once the economy reaches full employment, policy makers play an important role in an economy, because they are constrained in creating a balanced budget that avoids inflation [16].

4. The framework of fiscal policy

Establishing the fiscal strategy at the level of the society's political plan has direct effects on the economic plan, and, depending on the fiscal policy at national or regional level, there may be influences on the social plan of the country. Thus, any political choice affects the socio-economic component of the state and vice versa. Like individuals, states make decisions to achieve different goals, and in the economic context, decisions on fiscal policy target two important segments, namely: government revenues and government expenditures, with direct and indirect political and social effects.
The design of the taxation system can be considered an essential ingredient in public policy, as it mainly finances government spending. However, the taxation system is not just income, but based on extensive literature, can be considered a tool for: ensuring equity, establishing taxpayer-state relations, through which investments, productivity and economic growth can be supported. And, if tax systems are properly designed, they can increase governance, transparency, and fiscal accountability at the national level.
In addition to generating tax revenue, John Maynard Keynes in his 1936 book, namely "The General Theory of Employment, Interest and Money", suggested that the tax system could be used as a tool to change the consumer behavior of the taxpayer, depending on the state of the economy, in terms of saving or financial waste [11], thus he was promoting the concept of fiscal policy. He considered that in order to address the problem of economic instability, caused by fluctuations in unemployment, prices, inflation or deflation, the government could use tax revenues as well as government expenditures in the desired way, so as to obtain a constant rate of economic growth.
Keynes introduced the countercyclical fiscal policy desideratum, according to which in times when the economy of the state is in recession or depression, taxation should be reduced and / or state expenditures should be increased, in order to give the taxpayers an opportunity to have more financial resources for the purchase of goods or services. In this case we can speak about an *expansionary fiscal policy*, in which taxes decrease, incomes, investments, as well as consumption of the population increase, thus leading to growth in the economy.
Regarding the economic growth periods, he suggested that taxation should be increased or expenditures decreased, in order to reduce the taxpayers' resources and that the state's surplus revenues should be used as a reserve fund for periods when tax cuts will be needed. In this case, we can talk about a *restrictive fiscal policy*.
Keynes's conclusion is that a decrease in unemployment is only possible when investment is encouraged and consumption at national level is not affected by fluctuations. However, policymakers, although likely to have a negative and long-term impact on the economy, may find it

more difficult to cut spending than to raise taxes, as the latter can be implemented much faster and will provide revenue to the budget faster [1].

In a broad sense, we consider that fiscal policy is a complex system consisting of methods, means and tools, through which, through public institutions and related regulations, it is possible to distribute and use state resources, order to achieve the macroeconomic and microeconomic objectives.

The synthesis of Keynesian theory is still alive and foldable to the economy, providing a practical framework for fiscal policy [8]. Thus, starting from Keynes's principles, we can strengthen his statements by emphasizing that when the economy expands, the level of unemployment is weak and inflation is relatively low and there can be positive effects on all levels of society.

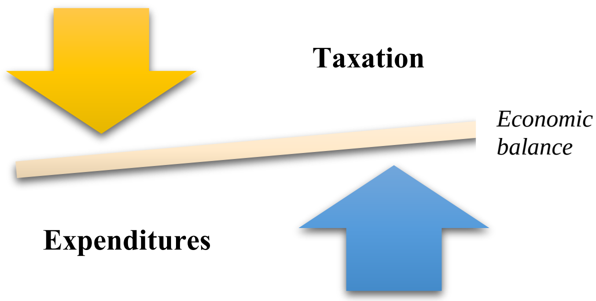
Given that the private sector generates jobs for the population, but at the same time financial resources to the state, through taxation, the government revenues, employment, and investment are growing. With low inflation, prices are stable and taxpayers have higher real incomes to save as well as to spend. Again, in this case, the payment of taxes and fees pours resources to the state budget. At the same time, governments can allocate more resources to government expenditures, in order to create new programs and to fund existing programs.

By continuing this path, it is possible to reach the welfare of the state, as well as of the taxpayer, person or entity. But, over time, economic periods change their course, and as the private sector shrinks, increases in unemployment can be seen, as well as declines in real incomes of the population. Thus, in order to deal with the situation, the previously established programs are reduced, taxes are increased, and the state uses either loans or reserve funds, which lead to a deepening of the public deficit or increases in inflation. In this case, budget revenues fall and expenditures increases, and the government is in a countercyclical position to pay more with fewer resources.

In this way, fiscal policy is able to stabilize the economic cycle, as well as stimulate social inclusion and support long-term economic growth, through its three functions, namely the allocation of public resources, distribution and stabilization function. Thus, the government it can influence the economy through its two instruments: taxation and expenditures [14].

In conclusion, the fiscal policy approaches two ways, which are not mutually exclusive, but they are complement to each other, respectively the expenditures and the tax revenues part, being a "switch" in choosing the optimal option of action, depending on the economic situation, according to figure no 2. The use of taxation and budget expenditures in order to influence the degree of development of the economy, makes fiscal policy to be considered the "medicine" of public finances, which can decisively change the future of the state.

Figure no 2. The „switch” of fiscal policy



Source: made by the authors, based on the study of the literature

These two instruments must be used together, as their importance cannot be differentiated, given that the state’s economic resources are limited, and therefore excess government expenditures leads to increases in public debt and decreases in private spending.

In the long run, each country has sought to design an efficient, stable and capable tax system that encourages and supports a developing economy [15], taking into account the three sectors of the state, namely the economic, social and political plan. Thus, *through the fiscal system*, one of the ways of transferring financial resources from the private sector to the public sector can be achieved, in order to finance the fiscal budgetary revenues. And, *through the adopted fiscal policy*, the state can remedy certain irregularities, as well as restore the road to the prosperity of society by imposing optimal tax burdens on the collection of tax resources from taxpayers, but also by establishing the correct structure and level of taxes, so that financial costs to be covered and the production and distribution of public goods and services not to be affected.

5. The conceptual mechanism of the fiscal system

Starting from the idea that the taxation system not only aims at raising financial resources for the state, but also contributes to development, economic stability and resource allocation, while supporting economic development [5]; [22]; [23], by summarizing the above, we can outline the conceptual mechanism of the fiscal system functioning, presented in the form of a scheme, in figure no. 3. This model takes into account the component elements of the taxation system, the relations between them, as well as the fiscal policy objectives, meant to influence the economic and social life of the state. In order to start and manage the taxation system, as well as at the individual level, the societies make decisions to achieve different objectives. These decisions are related to a few important steps.

The first step is to define the guidelines of public economic policy, at the level of society, based on the analysis of the macroeconomic and microeconomic situation at the level of country and regions. Based on the strategic priorities and with the help of the fiscal mechanism, but also with the observance of the legislative regulations, the *second step* of the administration of the fiscal system can be outlined. It is represented by the development of fiscal policy and the choice of the optimal variant of action, depending on the economic situation to be reached, so that the objective of achieving the fiscal process in conditions of equity, efficiency, economy and ethics (the 4E of performance fiscal) [3], to can be achieved.

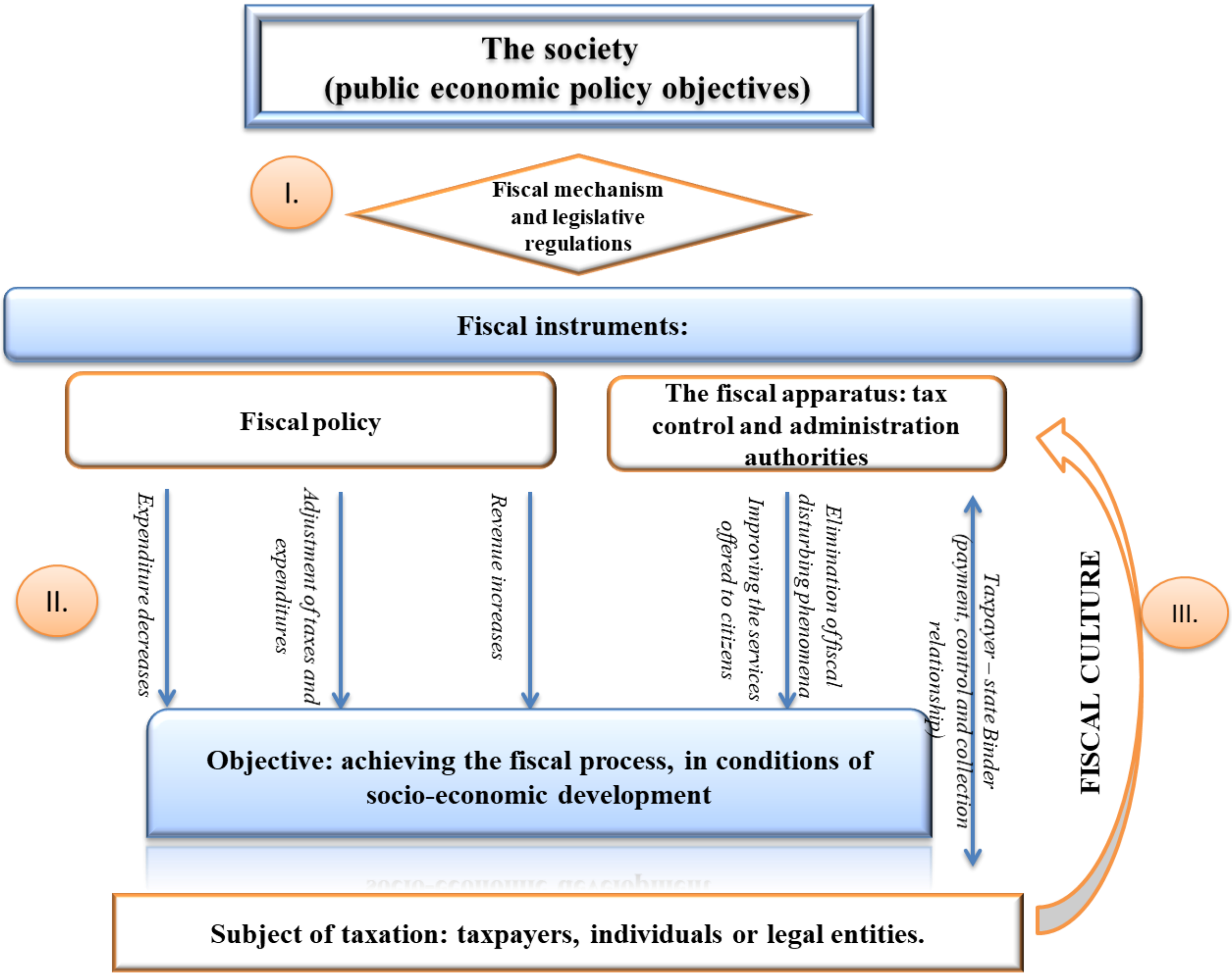
To select the type of fiscal policy, we will consider the adaptation according to the economic cycles:

- The reduction of expenditures, respectively of the budget deficit, is opportune during the economic crisis or during the period of stagnation, so that the fiscal process is carried out in conditions of economic recovery;
- During the period of economic stability, expenditure and revenue adjustment measures can be implemented and improvements can be envisaged among the characteristics of fiscal policy, related to the ratio between direct versus indirect national taxes and the distribution of the tax burden among taxpayers, so that to take steps towards raising the level of socio-economic and well-being of the population;
- Applying a fiscal policy of maximizing revenues, in order to obtain a budget surplus during the period of economic growth is being useful in accumulating reserves for periods of scarcity.

The third step envisages the formation of the taxpayer-state binder, through the tax authority, so that the objective of maximizing tax revenues is achieved in conditions of minimizing disruptive factors and actions. To achieve this goal, the tax culture or fiscal culture can be a decisive element, which must be deeply permeated in each country, and decision-makers to be aware of the positive effects it brings, by taking as an example, the countries where this new tax concept was long highlighted.

It should be borne in mind, however, that the decision to act in accordance with the law is also influenced by other tax factors, which take into account elements such as: tax base and tax rate, subject of taxation, distribution of tax burden, perception of corruption at national level, tax evasion, underground work, etc. and because of this, it is necessary to develop a modern tax system that takes into account the influence of internal and external factors.

Figure no.3 The conceptual mechanism of the fiscal system



source: made by the authors based on the study of the literature

6. Conclusions

The functioning of the fiscal system, so that the achievement of the objective of achieving the fiscal process, in conditions of socio-economic development, at theoretical and practical level, can be outlined based on the theoretical mechanism of functioning of the fiscal system, previously presented by this research. Therefore, in order to build an efficient fiscal system, we consider that all the interdependencies that have occurred must be taken into account, starting from:

- Designing the fiscal system, considered an essential ingredient in public policies and choosing the appropriate fiscal policy for the economic situation, as a result of national economic policy strategies, in compliance with legislative directions;
- Management of the modalities, procedures, fiscal rules for organizing the taxation system, without which the realization of the fiscal process cannot start;
- The measures for organizing, controlling and planning the activity of the fiscal apparatus and its capacity for improvement, so as to become a "bridge" between the state and the taxpayer;
- Building the national fiscal culture, which influences the state-citizen relationship through active participation and increasing trust in society and can lead to the decision to comply with payment of taxes and fees and also, can lead directly to increases in government revenue payments.

Based on the study, it was concluded that the use of public revenues and expenditures in order to influence the development of the economy, makes fiscal policy to be considered the "medicine" of public finances, which can decisively change the future of the state. In addition, it has been found that the taxation system, being a flexible element of the economic system, is a major force in the functioning of the economy, and interest in state fiscal resources is increased, because through taxes, periods of decline and stagnation of the economy, but also the effects of the crisis can also be minimized.

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