

INTERPRETING THE CORRELATION BETWEEN FISCAL POLICY AND ECONOMIC GROWTH IN THE REPUBLIC OF MOLDOVA

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Abstract: *Economic growth is one of the main objectives of the state's economic policy. The experience of several countries shows that most economic recovery policies are based on tax policy instruments, which generate favorable consequences for the real state economy. In this context, the topicality of the research theme can be underlined, which consists in the appropriate identification and optimal correlation of fiscal policy instruments according to the specifics of the national economy and the current stage of development in order to stimulate economic growth.*

Key words: *taxes, fiscal policy, fiscal instruments, budgetary revenues, tax burden, economic growth, gross domestic product.*

JEL CLASSIFICATION: E62, F43, H25, H30, O23

1. Introduction. Economic growth consists in improving the indicators of quality of life through a more efficient use of a country's available economic resources, representing the main axis of economic evolution over time. In the internal complexity of economic systems in the process of economic growth, along with direct factors such as - human and natural resources, the stock of technical capital, as well as technology, an essential role is played by indirect factors, with immediate action, being some catalysts in creating and combining direct factors, or which could eventually slow down this process. One of the indirect factors of economic growth is fiscal policy. [1]

Fiscal policy is an integral part of the economic policy of the state and is the art of determining the general characteristics of taxes, depending on the economic and social data of society [10]. In the policies promoted by the state, fiscal policy has a key role because with its help can influence and achieve real and sustainable economic growth, which positively influences the country's economy, living conditions of the population and creates a good image geoeconomically, in relation to other countries. Particular attention must be paid to the development of fiscal policy, which must reflect the basic objectives of the state and contain measures appropriate to the economic situation.

The possibility of using fiscal instruments, as a factor to accelerate economic growth, appeared in the fourth decade of the twentieth century, in the form of reorienting the Government's fiscal policy, proposed by J.M. Keynes. The application of Keynesian doctrines has led to the emergence of new methods of taxation and taxation, in order to stimulate the growth of global demand. Since then, taxation has been imposed and adapted to the demands of economic development, now becoming a favorite tool of state economic policy. [2]

The role of fiscal policy on economic growth was also experienced by President John F. Kennedy in the United States, who brought to Washington a group of prominent economists as consultants to the Presidential Economic Council in 1961. They applied Keynesian theory. One of the Council's proposals was to increase national income by reducing taxes. The aim of the proposal was to stimulate investment and consumption, which will ultimately lead to a higher level of income and a higher level of employment.

Subsequently, the role of fiscal policy in growth and employment was recognized by the Lisbon Strategy (2007) and the new Stability and Growth Pact (2005). The pact highlights the correlation between fiscal policy and structural reforms and sets out several ways in which fiscal policy influences economic growth.

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2. Analysis of the instruments for achieving the optimal fiscal policy in order to achieve economic growth in the Republic of Moldova. Fiscal policy has a favorable impact on the national economy when public actions are carried out taking into account the priorities of each stage of development. This will ensure the short, medium and long term economic and social effects. The objectives of budgetary and fiscal policy are closely correlated with the functions of the policy and their effects on the national economy. [2]

Speaking of the efficiency of fiscal policy, the current macroeconomic schools have been based on the development of specific hypotheses of neoclassicals (price flexibility) and Keynesian theory (price and wage rigidity). According to the first hypothesis, the expansionary fiscal policy has the effect of a reduced efficiency in the recovery of the economy, as the output reacts very little to the fiscal shocks. In Keynes's approach, fiscal policy also generates both short-term and long-term effects, and in the approach of neo-Keynesians - only in the short term.

Through taxes and fees, fiscal policy intervenes in the process of obtaining and distributing public revenues, thus influencing the economic growth of the state. In this sense, the main goal of an efficient tax system in an economy is to ensure stable and secure sources of public revenue. At the same time, an optimal fiscal system must achieve the following major objectives: encouraging the economic development of the state and supporting certain categories of people, socially vulnerable.

The state intervenes in the economic and social activity of the country, using the instruments of fiscal policy, which, in turn, contributes to the accumulation of budget revenues, gross national product, balancing the national public budget, achieving public financial control. Therefore, taxation is a key element that can influence the economy, determine the process of saving and investing, influence the growth of production and employment, all of which are goals of the country's sustainable economic development strategy. The primary objective of taxation is to procure resources for public authority, but at the same time it is used by the state to intervene in the socio-economic life of the country.

The impact of fiscal policy instruments on economic growth can be explained by the expression of GDP, from an expenditure perspective. Fiscal policy is effective if it generates a sustainable growth of potential GDP. The main instruments that can generate these effects are the taxes applied to the capitals and the productive public expenses, oriented in such fields as: research-development, education, public investments.[6] In addition to the direct influence on the component of government spending, fiscal policy can influence the other elements of GDP. Investments and consumption can be stimulated by reducing taxes (thus increasing disposable income) or by increasing budget expenditures (social spending, subsidies). Net exports may be encouraged through customs duties, subsidies or special tax facilities. At the same time, this can be achieved by reducing the tax rate or by financing from the public budget actions to support and promote exporters. [9]

Modern approaches to fiscal policy are based on the application of fiscal instruments in order to stimulate the economic growth of the state in line with the set objectives. Their realization can be possible only through a multidimensional, qualitative and active fiscal vision, by stimulating the initiative and reducing the risks.

Analyzing the impact of taxation on economic growth, the question arises whether a tax reform will generate favorable effects on economic activity, whether tax cuts will contribute to achieving economic growth. Following the decrease in the tax rate, tax revenues will decrease, increasing the pressure on the budget deficit, lowering the national level of the aggregate economy and therefore will generate certain gaps in economic growth. Practice has shown that the high tax rate inhibits economic growth, and the reverse situation, lower taxes, has positive but modest effects on economic growth.

The channels through which taxation influences the growth of production, and consequently the rate of economic growth, are:

- A high tax rate discourages investment;
- Taxes affect the labor supply, distorting the occupational decision or the decision regarding the acquisition of professional qualification;
- Fiscal policy can discourage productivity growth by not investing in research and development, areas whose effects stimulate capital and labor productivity;
- By distorting the volume of investment in sectors with a high tax rate to sectors with a lower tax rate and lower productivity, fiscal policy will have an impact on marginal productivity;
- A high rate of taxation on labor supply affects the efficient use of human capital, by the fact that employees are not motivated to work in sectors with high productivity, but too taxed. [7]

With reference to the coordinates of the fiscal-fiscal policy, the achievement of which can positively affect the economic growth, they aim at: the volume of public revenues, the budgetary balance, the origin of public resources, the level of public debt, limiting the increase of public expenditures. These targets, together with macroeconomic indicators, need to be met in national medium-term development programs and strategies. [4]

In this article, the author will analyze the economic growth of the Republic of Moldova, through several directions, the first being the dynamic analysis of the share of revenues, expenditures and public deficit in real gross domestic product during 2014-2020 (Table 1).

Table 1. Dynamics of the share of revenues, expenditures and public deficit in the real Gross Domestic Product during the years 2014-2020, %

| Indicators | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|--|------|------|------|------|------|------|------|
| The share of National Public Budget revenues in Gross Domestic Product | 33.8 | 34.8 | 36.6 | 42.5 | 46.2 | 50.2 | 49.9 |
| The share of National Public Budget expenditures in Gross Domestic Product | 35.4 | 37.0 | 38.6 | 43.4 | 47.5 | 52.6 | 58.4 |
| The share of the deficit of the National Public Budget in the Gross Domestic Product | -1.6 | -2.2 | -2.0 | -0.9 | -1.3 | -2.4 | -8.5 |

Source: Prepared by the author based on the Reports on the execution of the national public budget for the years 2014-2020 and the data of the Statistical Data Bank "Statbank" available on: <http://mf.gov.md>, <http://statbank.statistica.md>, (quoted 18.07. 2021)

Data on the volume of budgetary resources in gross domestic product reflect fluctuations from year to year and are in the range of 33.8% (2014) to 50.2% (2019) in GDP, with an average level of 42.0%. Also, the share of budget expenditures in GDP fluctuates significantly from year to year, registering a continuous increase from 35.4% (2014) to 58.4% (2020), the average growth being 44.7%.

The efficiency of the fiscal policy and of the economic growth is not only dependent on the influence of the recession on the consumption / investment behavior of the economic agents, but also on the amount / dynamics of the public debt for the economies in recession. Thus, countries characterized by high structural budget deficits, accumulated during the period of economic expansion and large public debt services to be paid during this period, will have to promote rather restrictive fiscal measures, aimed at increasing the confidence of external creditors in the ability to sustainably strengthen public finances. Otherwise, fiscal expansion to high levels of public debt will be perceived by consumers as being followed by tax increases, which will have recessionary effects on the economy. Consequently, there will be a positive impact of expansionary fiscal policy on the economy only in the event of low public debt.

Analyzing the situation of the budget deficit in the Republic of Moldova, it is attested that in the analyzed period the budget balance was in the range: from 0.9% (2017) to 8.5% (2020) in GDP. The functional coordinate of the budgetary-fiscal policy on the budgetary balance consists in limiting the deficit, the budgetary surplus in the gross domestic product, having a primordial role in the long-term macroeconomic stability. Therefore, at EU level, budgetary convergence

criteria restrict the level of the budget balance by up to 3% of GDP. According to this criterion, the Republic of Moldova was within the established limit during the analyzed period, except for the year 2020, which was marked by a sudden review caused by the Covid-19 pandemic.

Another important indicator of fiscal policy is fiscal pressure, with significant and functionally relevant implications. The analysis of the fiscal policy of the Republic of Moldova and its effects allowed to identify its main problem, which consists in identifying the balance between the need to increase incomes as the main source of expenditures, aimed at reducing poverty, and the need to support the business environment economic growth. [3]

Fiscal pressure generally affects a country's economy. It generates unfavorable results both socially and psychologically. Although most of the revenue accumulated in the state budget is returned to the economy through public spending, the fiscal pressure still creates tensions among taxpayers. The high fiscal pressure causes a slowdown in economic activity and entails a decrease in the tax base and thus public revenues. Also, investments and savings are no longer stimulated, which can lead to economic and social crises. Globally, we mention that the fiscal pressure is a problem faced by the vast majority of countries, considering that being sec. XXI, tax systems tend to modernize, to improve. The economic crisis and the difficult times of the world economy have raised the issue of "relaunch", governments have turned to reforms aimed at easing fiscal pressure.

Table 2. The evolution of the fiscal pressure in the Republic of Moldova during the years 2014-2020

| Indicators | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Fiscal revenues of the State Budget, million lei | 21929.2 | 23648.5 | 26125.6 | 31201.5 | 34057.9 | 36417.2 | 35777.2 |
| Fiscal revenues of the Local Budget, million lei | 2924.5 | 2334.8 | 3105.5 | 3274.3 | 3602.2 | 3637.0 | 3975.0 |
| Fiscal revenues of the State Budget and of the Local Budget, million lei | 24853.7 | 25983.3 | 29231.1 | 34475.8 | 37660.1 | 40054.2 | 39752.2 |
| share in real Gross Domestic Product, % | 19.8 | 19.5 | 19.2 | 20.5 | 20.2 | 20.1 | 20.3 |
| Social insurance contributions, million lei | 8362.6 | 9273.1 | 10036.5 | 11864.0 | 13037.9 | 13635.7 | 14295.5 |
| share in real Gross Domestic Product, % | 6.7 | 7.0 | 6.6 | 7.0 | 7.0 | 6.8 | 7.3 |
| Health insurance premiums, million lei | 2414.5 | 2854.6 | 3240.2 | 3648.4 | 4117.6 | 4768.2 | 4939.6 |
| share in real Gross Domestic Product, % | 1.9 | 2.1 | 2.1 | 2.2 | 2.2 | 2.4 | 2.5 |
| Total Tax revenues, million lei | 35630.8 | 38111.0 | 42507.8 | 49988.2 | 54815.6 | 58458.1 | 58987.3 |
| Total fiscal revenues Revenues of the National Public Budget, % | 83.9 | 87.2 | 92.5 | 93.7 | 94.5 | 92.9 | 94.1 |
| Fiscal pressure (% of real GDP) | 28.4 | 28.6 | 27.9 | 29.7 | 29.4 | 29.3 | 30.1 |

Source: Prepared by the author based on the Reports on the execution of the national public budget for the years 2014-2020 and the data of the Statistical Data Bank "Statbank" available on: <http://mf.gov.md>, <http://statbank.statistica.md>, (quoted 18.07. 2021)

Not every state can be characterized by the existence of a rational fiscal policy and an effective mechanism for its implementation. One of the indicators that allows the evaluation of the effectiveness of the fiscal policy implementation at macro-level is the fiscal pressure index. Fiscal pressure or tax rate depends on a series of factors related to the tax system, such as: number of taxes, methods of calculating the tax base, facilities granted, as well as exogenous factors such as production volume, external relations and other relevant factors the impact of the policy on economic growth must be taken into account in the process of developing the shadow economy and tax evasion, as a consequence of the application of excessively high tax rates.

Thus, the level and dynamics of the tax rate of the Republic of Moldova during 2014-2020 are presented in Table 2.

Another major coordinate of fiscal policy is the source of financial resources. A key objective is to accumulate financial funds from own sources. According to the data in Table 2, the financial funds are formed based on fiscal sources in the proportion of 83.9% (2014) - 94.5% (2018) in the total volume of revenues of the national public budget.

To test the relationship between fiscal policy and economic growth in the Republic of Moldova is presented in Figure 1.

As can be seen from Figure 1, there is a strong correlation between fiscal policy variables and the rate of economic growth in the Republic of Moldova in certain time intervals (2015-2016 and 2018-2020). In the period 2015-2016 it is found that tax revenues and gross domestic product had a positive upward trend. At the same time, in the period 2018-2020 there was a negative trend of decreasing the respective variables. Both theoretically and practically, it is not excluded that in that period there were other factors influencing economic growth. Public finances have registered favorable developments. This assumption is based on the fact that tax revenues increased in a proportion higher than that of gross domestic product in 2014, 2015, 2017, 2020.

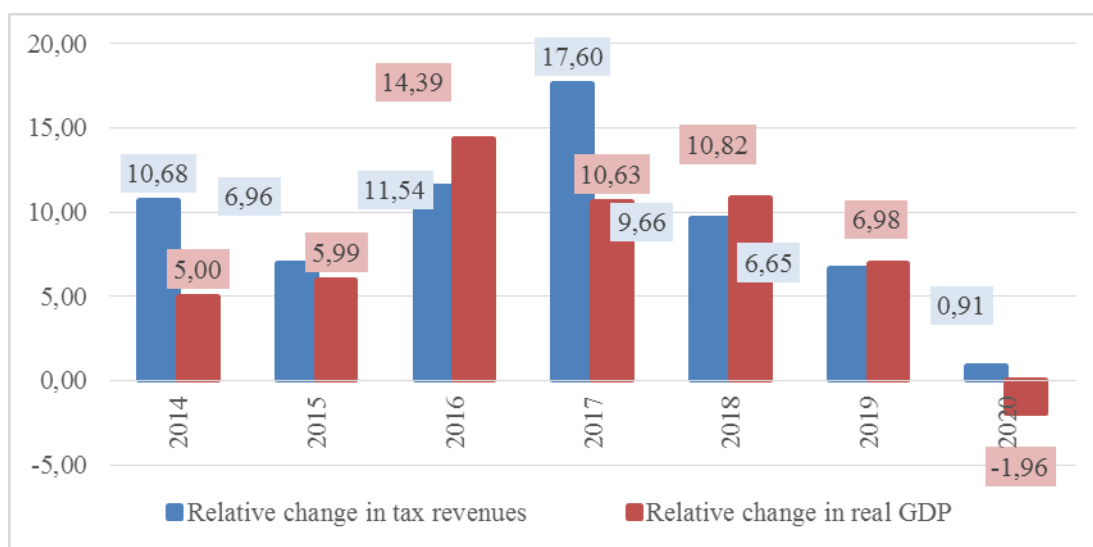


Figure 1. Correlation between the relative change in tax revenues and the change in real GDP during 2014-2020, %

Source: Source: Prepared by the author based on the Reports on the execution of the national public budget for the years 2014-2020 and the data of the Statistical Data Bank "Statbank" available on: <http://mf.gov.md>, <http://statbank.statistica.md>, (quoted 18.07. 2021)

There are numerous economic theories and research based on empirical calculations and simulations, which have studied the dependence of economic growth on budgetary-fiscal variables. This relationship is considered to be most successfully explained by endogenous growth models.

In order to stimulate economic growth, fiscal policy needs to promote a certain structure of budget revenues and expenditures. As a result of the objective of accumulating public revenues in increasing volume, there is an increase in fiscal pressure, which distorts the behavior of economic agents, affects production, and therefore economic growth. At the same time, the degree of distortion varies depending on the type of public revenue. Taxes on the income of individuals and legal entities are income with a strong distortive impact, therefore they are distortive taxes. At the same time, the effect of taxes and excise duties is less distortive, so they are neutral or non-distortive taxes. Under certain conditions, increasing the share of undistorted taxes in the total volume of public revenues has a positive impact on economic growth. This

occurs when non-distortive tax revenues are used to finance productive budget expenditures. Even if distortive taxes affect the rate of economic growth to a lesser extent than non-distortive taxes, they are necessary because they fulfill other functions promoted by fiscal policy.

Similarly, public spending stimulates economic growth, but not all types of spending have a positive effect on the growth rate. Therefore, productive spending has a positive impact on economic growth, at a time when government consumption does not stimulate economic growth. [8]

The forecasts resulting from the endogenous growth models have as a starting point the classification into four categories of the elements of the national public budget: distortive or non-distortive taxes and fees, as well as productive or unproductive budgetary expenditures.

In this article, the impact of fiscal policy on economic growth is also analyzed based on the structure of public revenues by distortion (starting from the distortions it generates on the level and rhythm of revenue and payment flows). The quality of the tax policy established and promoted by the government is assessed in relation to the share of undistorted taxes in the total volume of public revenues: the higher the share of undistorted taxes, the higher the quality of tax policy. [8]

Therefore, the share of distorted and non-distorted revenues in the total volume of revenues of the national public budget during the years 2014-2020 is presented below (Table 3). According to the data in Table 3, the analysis of the structure of public revenues indicates that the share of distorted and undistorted revenues in the total volume of public revenues has an increasing trend.

Table 3. Share of distorted and non-distorted revenues in the total volume of BPN revenues in the period 2014-2020,%

| Indicatori | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---------------------------------|------|------|------|------|------|------|------|
| Distorted taxes and duties | 37.7 | 41.3 | 43.6 | 44.2 | 46.3 | 44.7 | 46.2 |
| Non-distortive taxes and duties | 15.2 | 15.4 | 16.0 | 15.8 | 16.0 | 15.9 | 16.1 |
| Other public revenues | 47.1 | 43.3 | 40.4 | 40 | 37.7 | 39.4 | 37.7 |

Source: Source: Prepared by the author based on the Reports on the execution of the national public budget for the years 2014-2020 and the data of the Statistical Data Bank "Statbank" available on: <http://mf.gov.md>. (quoted 18.07. 2021)

As mentioned, the quality of the tax policy established and promoted by the state is assessed according to the share of undistorted taxes in the total volume of public revenues, which according to the analysis in 2014-2020 is quite small and varies between 15.2% (2014) and 16.1% (2020). However, it has an upward trend over the period under review, which is positive in endogenous economic growth models. However, at the same time, the increase in the share of distorted revenues in the total volume of public resources, which varied in that period from 37.7% (2014) to 46.3% (2018), is negatively appreciated. Socialists, such as: Hungary, Russia, there is a reverse trend - increasing the share of undistorted taxes in budget revenues. The conclusion that emerges from the analysis is that, although there are some positive trends, however, the structure of public revenues is not beneficial for applying endogenous economic growth models.

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The fiscal aspects applied in the Republic of Moldova also have an influence on the inflation rate. Therefore in the figure below we can see the evolution of the inflation rate during the period 2016-2020.

Examining figure 2 regarding the evolution of the inflation rate in the Republic of Moldova, we can see that in the analyzed period the highest level of inflation rate was recorded in 2017, and the lowest level was recorded in 2018, year in which major changes were made regarding the share of personal income tax, thus moving to the single rate of 12%, also this year we could see the effects of the restructuring of the fiscal body State Tax Service started in 2017, at the same time the downward trajectory of inflation was supported by the decrease pressures from regulated prices.

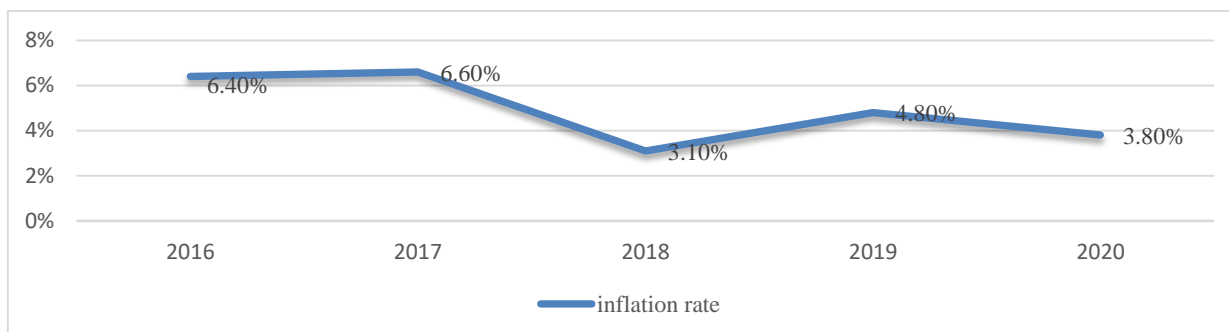


Figure 2. Evolution of the inflation rate in the Republic of Moldova during 2016-2020

Source: Prepared by the author based on statistical data presented by the NBM

Compared to 2016-2017 when the inflation rate reached around 6%, we can say that in 2019-2020, even if we have a small increase compared to 2018, the inflation rate is still declining and remains at a allowable value. The decrease in inflation and fiscal pressure in the context of the increase in BPN revenues, indicates a positive result and a healthy growth of the economy.

One of the basic economic problems in the case of the Republic of Moldova is the insufficiency of investment resources allocated in the country's economy. Attracting investments In the Republic of Moldova, it is a key objective of the state's investment policy by applying a coherent fiscal policy. Capital investments, as the main source of economic growth, have several effects, one of which - the expansion of the tax base and the creation of additional sources of revenue for the national public budget. Stimulating the investment process is often analyzed in conjunction with lowering the level of taxation or tightening fiscal policies. The investments refer to the main contributing factors of the economic growth, for this reason the increase of their allocation in the country's economy is appreciated as a priority task of the state. Table 4 presents the data on the volume of investments in relation to the GDP in the Republic of Moldova compared to other states.

In the Republic of Moldova, the share of investments in fixed capital in recent years has exceeded 76%, which has led to: broadening the reproduction process, increasing the economic potential of the state, etc.

Among the state levers of influence on the investment process, in order to regulate it, an important place is occupied by fiscal policy. World practice, in regulating capital investment processes, eloquently demonstrates that one of the direct taxes, namely the income tax of legal entities, has become a very effective lever.

Table 4. Share of investments in GDP, (%)

| The country | Share of investments in GDP, (%) |
|---------------------|----------------------------------|
| China | 46 |
| Japan | 36 |
| Poland | 31 |
| France, Italy | 26 |
| US | 24 |
| UK | 23 |
| Russia | 20 |
| Republic of Moldova | 18,5 |

Source: Prepared by the author based on the World Investment Reports, www.unctad.org/wir

The analysis of the effects produced by taxation on the financing of investments needs to be extended, in order to highlight the disseminated effects that appear as they influence the monetary and financial flows from the economy and return to the economic companies.

In the Republic of Moldova, in recent years, a lot of measures have been taken to regulate investment processes. At the same time, exemptions from the payment of income tax of legal entities were considered as a basic instrument of fiscal stimulation of investments.

Through direct taxes, the state can stimulate the processes of attracting foreign investments as one of the important sources for capital investments in the economy of the Republic of Moldova.

According to world practice, attracting foreign investment has a positive influence on the economy and contributes to:

- development of the production process;
- transfer of new technologies;
- widening the tax base, becoming an additional source for supplementing budget revenues;
- development of certain regions of the country;
- increasing the competitiveness of enterprises and their production;
- the appearance of the possibilities to exit on the world markets, etc.

Although there are many positive aspects in attracting foreign investment, the global practice of investment cooperation of states with different levels of socio-economic development, attests to the fact that the penetration of foreign capital from developed countries into the least developed from an economic point of view and social can become a serious obstacle to strengthening the territorial integrity and independence of the receiving state.

Among the factors influencing the flow of foreign investment, we can state a no less important factor, namely, the fiscal climate. Under current conditions, the importance of this factor has weakened slightly, giving way to other factors, such as: political and economic stability; investment guarantees. But the existence of a favorable fiscal climate continues to be of interest to investors. The existence of a favorable fiscal climate does not only mean the presence of light tax regimes, but also ensuring stability and the possibility to predict the evolution of the taxation system, which would allow investors to develop long-term plans for his entrepreneurial activity.

Achieving sustainable economic growth is linked to the establishment and implementation of an appropriate budgetary strategy, which would harmonize fiscal policy, state spending policy, including in the area of state investment and public procurement, the domestic government debt strategy and appropriate measures to finance the budget deficit public. [5]

Various economists have researched the topic related to the influence of aspects of budgetary and fiscal policy on economic growth. The research results were different, depending on the analyzed region and the development stage. However, it has mainly been shown that fiscal and fiscal policy, together with the tools to achieve it, influence a country's economic growth.

Fiscal policy can be applied differently depending on the stage of economic development. In times of recession, expansionist policies are indicated, which consist of reducing taxes and increasing public spending, aimed at stimulating economic growth. On the other hand, in periods of excessive expansion, restrictive policies can be used, which consist of increasing taxes and reducing public spending, designed to combat inflation and prevent the economy from overheating. [9]

Fiscal policy must also be tailored to each country, as each country has a specific economy and political, economic, climatic, and geographical conditions that must be used appropriately in order to successfully achieve state objectives and make progress. It is very important that, in improving fiscal policy, for economic growth, to take into account the experience of other countries in taxing revenues. But this experience should not be fully applied in the conditions of the Republic of Moldova, without taking into account the specifics and degree of development of the country, the way the financial market works. The logic of the

entire fiscal policy must be conceived as a harmonious combination of incentives and restrictions, so as to stimulate entrepreneurship, the propensity to save economic agents and the population, accelerate the restructuring process and increase the adaptive capacity of enterprises to change. this policy must harmoniously combine the requirements of tax relief (in order to provide economic agents and the population with a sufficient share of income, manifested in an appropriate demand for consumer goods and investment able to stimulate supply and demand; encourage economic activity), with those on balancing the state budget and more accurately assessing the directions of use of budget revenues, the efficiency of public spending.

3. Conclusion. In conclusion, the fiscal policy has the decisive role to interrelate the rest of the macroeconomic policies: monetary, structural, budgetary, investment entrepreneurship, having major effects and consequences on the economic situation. The debates regarding taxation are explained by the existence of the multitude of functions related to the tax system in order to ensure economic and social balance. Through fiscal policy instruments, the state implements the reforms that underlie national development strategies. Currently, the tax has become an instrument of economic and social policy, applied in order to achieve the objectives of economic stabilization. Among the objectives of budgetary and fiscal policy, economic growth is paramount in importance.

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