THE COORDINATES OF THE FINANCIAL POLICY

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ABSTRACT. The importance of the financial policies is more than evident in the context of the nowadays financial crisis. We understand the financial policy as a process of conciliation of the different possible ways to constitute and use monetary funds taking into account their implications for the socio-economic life of the community administered by an authority. This paper analyse the coordinates of the financial policy, focusing on its role and objectives, but also on its instruments and restrictions.

Keywords: finance, public finance, policy, public revenues, public spending, financial policy

1. Some Preliminary Observations

One of the authors (Giurgiu 1995) presented, his position in what concerns the meaning of the word “finance” which we regard as being an ensemble of monetary funds, flows through which these monetary funds are formed and consumed and the formalized in law social interactions generated by their movement. At that point we stated that the word ‘finance’ is a generic term which covers several concrete (operational) forms of manifestation having the same common content but justifying their separate existence by certain particular features, generated by the specific underlying socio-economic circumstances. All these forms may be ordered according to several criteria. The most common classification criterion would be the purpose for which the monetary fund is set up. From this point of view, we maintained that the multitude operational forms of manifestation of finance could be classified into two large groups which are the public finance and the corporate finance.

Public finance plays an essential part in the adjustment of the general economic mechanism through a complex network of interdependences

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between public revenues raising and spending. Given the way they function, we are led to regard these interdependences as a system and every system implies a functioning mechanism.

The different meanings with which the concept of ‘mechanism’ is used are clarified in the economic literature. In connection with this aspect, we would like to turn to an observation from a work published more than twenty years ago, which nonetheless holds true to a large extent even nowadays. At that point, it was underlined the fact that in order to respect the accuracy of the analysis and the rigor in expression two meanings of the word ‘mechanism’ should be taken into account. First, the concept is used to make reference to a correlated ensemble of financial interactions thus acquiring the meaning of ‘system’. Second (but simultaneously), the concept also denotes the body of rules that govern the transformation of the funds’ utilisation effect into positive financial results. The book we have cited (Giurgiu, 1995) discusses the financial mechanism of the firm and consequently refers to the transformation of the firm’s funds utilisation effect into profit.

Returning to the object of our research we put forward the idea that in the public finance area too the concept of ‘mechanism’ should be dealt with by taking into account its two meanings: correlated ensemble of public funds, monetary flows and financial relations, from which derives the system character of public finance, but also a body of regulations which govern the levy and spending of public revenues so as to stimulate general economic growth and the improvement of the entire population’s living standards. As we aim at identifying the way in which processes in the area of public finance ultimately influence the economy and the society we will focus to a larger extent in our study on the second meaning of the term ‘mechanism’, which rather bears more resemblance with the biological concept of ‘organism’.

The regulation that governs public revenues collection (in most cases imposed by means of law coercion so according to the public authority’s standpoint) as well as the purpose and manner of spending the public funds, which are established by those who administer the community at different moments, represent by nature the result of a specific way of thinking, a specific attitude towards the public needs’ assessment (to what extent these needs are real and adequate) and most important, satisfaction. It follows that the construction of the public finance mechanism is strongly influenced by the underlying financial policy.
Due to the fact that the firms’ needs (whether they are industrial, commercial or banking firms) do not always perfectly match the interests of the entire collective in which the multitude of firms conduct their business, corporate finance in its turn reveals its essence and plays its part through a mechanism, more or less correlated in what concerns its functioning, with the mechanism of public finance.

2. Financial Policy

2.1. As to the Concept of Politics

The object of our remarks is represented by the financial policy, but we shall not tackle it without shortly calling to mind the definition of the term ‘politics’. The body of literature referring to the concept of politics is considerable in size: beginning with Plato continuing with Aristotle and St. Augustine’s writings as well as the work of Machiavelli, Hobbes, Hume, Locke, Knight, Montesquieu, Rousseau and arriving at Samuelson, Aron and Buchanan, to mention just a few personalities who have looked into the content of this ancient human occupation. We thus have at our disposal a vast and profound analysis of the term’s signification. There are a great number of definitions, not necessarily in contradiction with one another. However, according to the objective of the desired demonstration, each of them emphasises certain aspects of the subject while not taking into account the others. Providing an analysis of these definitions is beyond our competencies and the scope set for the present study. Considering the demonstrations to follow we shall go over some very short definitions which in our opinion best satisfy the requirements of the present paper. Beforehand we would like to call to mind a very old adage, credited by everyone throughout history and thus having become an axiom, which maintains that politics exist because social ensembles need to be governed.

In a relatively recent treatise on political ideas of the twentieth century it is put forward that politics represents the exercise of the decision-making power (Chatele and Pisier, 1994: 511). Somehow similarly, at least in what concerns the content, the Nobel Prize laureate in economics, Buchanan (1997: 21), defines politics as a process of differences reconciliation. The exercise of the decision-making power, even within a process of differences reconciliation, starts from certain interests or to be more specific, from certain standpoints regarding the safeguard of the collective interest. This translates into highlighting the existence of various types of interests. From this point of view, politics cannot be other but subjective. As Buchanan
notes, there is no such thing as a neutral politics because collective interest takes shape as a result of the reconciliation of differences and within this process there is always a dominant interest that prevails. The entire history of mankind, and especially present times, proves too well this state of affairs. So it is always about seeking to satisfy an interest, even if those who draw up a certain policy present it as holding good for the entire collective (the entire nation). In this case, everyone’s interests are inevitably assessed through this groups’ particular manner of assessment.

Beyond the non-neutral character of politics, the exercise of decision-making power or the process of reconciling the differences (between different interests or different standpoints concerning collective interest aggregation and satisfaction) must comply with certain rules in order to attain its revealed or unrevealed goal. Were we not afraid to generate confusion with the idea of the financial mechanism that we put forth above and upon which we will insist in our research we would be tempted to advance the idea of the existence of a policy framing and implementation mechanism.

The set of rules which governs the process of policy designing and implementing should cover aspects like: defining the specific field of human action taken into account, setting forth the policy’s objective, defining the levers used to attain the objective, the policy’s time-span, the means used to measure the environment’s reactions and so on. Usually, we refer to policy in general, but consciously or not, we always have in mind a particular, actual form of policy, that is, a specific area that will be impacted by the policy. We situate ourselves in the financial area of human activities. From this point of view, we cannot continue without calling to mind an extremely suggestive statement made in one the books, recently translated to Romanian, of the Nobel Prize winner in economics, Stiglitz (2005), who observed upon a certain type of financial policy that ‘While a tax system model represents a perennial source of controversy – point of view concerning the equity-efficiency ratio equilibration, a compromise difficult to reach – there is a widespread consensus on five principles that characterize a good tax system: fairness with its two aspects, efficiency, simpleness in its administration, flexibility and transparency’ (Stiglitz and Walsh, 2005: 307-308).

2.2. Financial Policy and Its Instruments

After choosing a definition of the concept of politics in general, it is a lot easier for us to attempt a definition of the financial policy. Therefore, we believe that financial policy may be defined as a process of conciliation of the different possible ways to constitute and use monetary funds taking
into account their implications for the socio-economic life of the community administered by an authority.

The same Nobel Prize laureate, Stiglitz (2005), notes that financial policy, which he names fiscal policy, targets the three chief objectives of macroeconomic policy: stimulating economic growth, a low and stable inflation and full employment. There is a number of alternatives to constitute and use monetary funds, but they present different implications and especially a contradictory manifestation in time of these implications. Designing financial policy is dramatic, as its present positive effects may turn, sometimes unexpectedly fast, into negative effects. The differences’ conciliation process requires extremely painstaking research and most of all risk taking, risk being expressed as the probability of occurrence of the unwanted events, or nobody can guarantee that the disrupting events could not occur in the considered time span when framing a certain financial policy. The predictability horizon of financial policy – horizon being characterized by a sufficient degree of credibility – is relatively narrow and inevitably exposed to risk factors.

Certainly, financial policy is particularized to areas of the financial domain which are as narrow as possible: tax policy, public expenditures policy, budgetary policy, customs policy, and so on. The elaboration of each type of financial policy is performed, or should be performed, correlative, that is by taking into account their aggregate effect on the socio-economic environment and the environment’s reaction speed along with the inherent implications for the future financial flows. Considering the ever increasing speed of developments within the environment (in connection with this aspect, one should mind the ever closer connections between the internal and the external environment) we realize the considerable difficulty of designing a successful financial policy ‘a la longue’. Although the information technologies and the present technical support allow the creation of a considerable number of scenarios, each of them has a certain specific probability of success and failure. Therefore it is a utopia to discuss about financial policies with a level of certainty of one hundred percents. This uncertainty is also amplified by the fact that a financial policy is always designed by various echelons of the political scene.

These various standpoints have during certain time intervals a higher degree of validity, and during others a lower degree of general acceptance. Even for states with a totalitarian political regime the inherent disputes within the ruling group (which only seems to be united) make it impossible
to elaborate a financial policy that reflects the national interest on long time intervals. The recent history of the East European countries fully supports the previous statement. All the above suggest that we situate ourselves in the public finance area.

If until the end of the 18th century and even during the 19th century, the effect of the public funds formation and spending on the socio-economic life was overlooked, nowadays, no country whatsoever would adopt this simplistic point of view in relation to public finance. The constitution and spending of public funds are performed by carefully taking into consideration their multiple and contradictory implications for every aspect of human activities. For this reason, the main instrument of the financial policy is the financial lever.

Public funds are formed through a large variety of input flows (revenues) and output flows (expenditures). Even in the situation where all types of flows would only have as main purpose the formation and use of public funds (so as to ensure the functioning of the state apparatus in its most simplistic dimension), without having any objective besides the strictly financial ones, they would still exert influence generated by their direct effects on the taxpayers’ private finance as well as by their indirect effects on the public funds receivers’ revenues. If a monetary flow and the connected financial relation are also assigned to some other objective, generally not pertaining to the financial field, then we can speak about a financial lever. It represents a direct intervention of the State in the economy, because through the mere movement of the monetary flows, certain tendencies and behaviours within the socio-economic life are encouraged or discouraged (usually, each state claims that by doing this they seek to increase the general welfare).

According to Vacarel (2000: 97), the additional objective not pertaining to the financial area must have a well defined role in the socio-economic life, which is to organically integrate into the functioning mechanism of that specific area of the socio-economic life. Only under these circumstances one can speak about a financial lever.

Nowadays’ reality proves that almost all (we do not use the word ‘all’ so as not to be accused of exclusion) monetary flows target, from the beginning, other objectives than the mere formation or spending of a public fund. As a consequence, the area of financial levers matches the area of all monetary flows.

In our understanding, a monetary flow acquires the quality of financial lever through the financial policy decision-making, so through a subjective
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act of leadership. This is the reason why we have considered the financial lever, above, to be the chief instrument of financial policy. Hence the main role belongs to the financial decision-making, that is, to the fundamental element of the financial policy.

There are a large number of studies concerning the financial levers within the economic literature to the point that financial levers are regarded as synonym of financial relations as such, reaching thus a higher degree of objectivity. Nonetheless, we must distinguish out of this multitude of monetary flows the financial levers which are used the most and which generate the most significant effects in what concerns stimulating and encouraging certain activities or social groups, or on the contrary, in the sense of restraining or discouraging them.

Financial levers as instruments of financial policy form a system which encompasses economical-financial levers (the wage lever, the price lever and so on) and financial-monetary levels (the interest rate, subsidies, foreign exchange rate, taxes and so on).

Certainly, within this system it is desirable that these levers complete each other, and if one of them does not produce the expected effects anymore or annihilates another’s effects it should be excluded or replaced. Moreover, financial levers must be elastic and flexible enough to adapt to the socio-economic life’s dynamics.

In this respect, the importance of the financial levers becomes up to date in an abrupt manner, in the context of the financial crisis we are going through, and the advocate of State’ intervention in the economy, John Maynard Keynes is nowadays probably the most cited economist. The free market (whose virtues we regard as being beyond any shadow of a doubt) does not hold the blame for the present financial crisis, but the poorly regulated market and we refer here especially to the financial market. Thus, as a solution of last resort, the state has been urged to intervene whether directly or indirectly, brutally or more subtle, but engaging all the instruments at its disposal. The interest rates have been cut several times to incredible levels (0.3% in Japan or 1% in USA) and with unprecedented speed. Moreover, on October 8th 2008 this type of measure has been undertaken in a coordinated manner and simultaneously by the seven most important central banks worldwide (Federal Reserves, European Central Bank and the National Bank’s of Canada, England, Sweden and Switzerland). In addition, massive flow of liquidities have been injected into the system, some large banks and renowned insurance companies have
been nationalised (certainly, only a temporary measure – we would like to believe), exchange rates have been supported for some currencies and the list continues.

This crisis has unveiled a whole arsenal of financial levers at the State’s disposal – some long forgotten in the western countries – as a solution of last resort to stabilise a financial system on the verge of collapse. As a consequence, the intervention tools are there, the only problem being to use them in a coordinated way, within a realistic and rational financial policy, so that the difficult task of saving the financial system can be successful.

2.3. Some Observations Concerning the Financial Policy Design Mechanism

Practice has built (we wouldn’t like to say ‘intuitively’, but we dare to say ‘by doing and learning’) a system of rules concerning a financial policy’s design. Even if it does not make the object of an extensive theoretical treatise, this system of rules is being used with more or less consistency according also to the creative potential of the ruling parties. As we all know, any financial policy is designed with the purpose of attaining a certain objective outside the financial area through a series of financial levers, which usually have a financial nature and function within a system of restrictions. These restrictions are extremely well determined by the degree of socio-economic development as well as by the complexity of the international socio-economic relations for each moment in time.

When choosing the object of a financial policy, certain logic must be observed. We have developed this observation from a statement made by the theorists of the systemic analysis, statement which has become an axiom and according to which political activity can be reduced in essence to the scientific administration of a section of the social life.

We call for rationality when choosing the objective in two respects. On one hand, the objective must integrate itself into the general socio-economic realities specific to one country at a certain point, and on the other hand, it must be sensitive to the effects of the financial levers selected for the intervention. In what concerns the first aspect, we not only have in mind the correlations with the direction and rhythm of factors determining the socio-economic reality, but also the feasibility of the proposed objective, precisely under the considered circumstances. In order to exemplify the aspects we presented above, we call to mind the famous ‘task’, formulated about two decades ago in a world which has since become obsolete, making
reference to the Romanian industry’s obligation to provide high quality products “with at least 5% above the world level”.

The difficulty, to put it this way, of establishing the objectives of the financial policy is still present in the current transition period. Starting to privatize state owned companies, without previously performing a thorough overhaul of the industry, led to a great number of fiascos in this process and to a surge in debt to the state budget. All these had a negative influence on the efficiency of the domestic economy and through this the population’s standard of living. Certainly, those difficulties may also find an explanation in the numerous hardships beyond the economic sphere, but we shall take a closer look at them when we bring into discussion the third element of the financial policy, namely the system of restrictions.

In what concerns the sensitivity of the financial policy object to the action of the financial lever selected for intervention we observe that, in an important number of cases, the objective which has been properly set does not suffer, at least in theory, any alteration although the lever is in action. Tax laws allow firms to take advantage of an accelerated depreciation system for the fixed assets. However, a rather small number of companies actually resort to this beneficial law provision and the situation is similar with regard to provision formation. A more detailed examination of the matters leads us again to the deficiencies in the system of restrictions within which any policy is designed.

The discussions regarding financial policy focused in general on the financial levers. Although some of the formulated definitions do not come very naturally (though not explicitly, one of the authors quoted above admits state intervention through administrative measures), and others imply in an unrealistic manner an ‘harmonization’ of the economic agents’ interests with the public interest, all those who published in this field agree that a category may play the role of a financial lever only if besides the main financial objective (the constitution and spending of monetary funds) it is also assigned another objective which is usually outside the financial field and which is vested with a certain public interest.

Basically, as we pointed before, all the monetary flows may play the role of financial levers, meaning they may be related with desirable events from all the other human activity areas. In our opinion, the problem is to find in each case that monetary flow which is in the closest relation with the pursued objective. We could compare the issue above with the relation between the variation of the independent variable (in this case the monetary
flow) on one hand, and on the other hand, with the variation of the dependant variable (the pursued objective), from the correlation field. Certainly, this correlation cannot be imagined, but it has to result from several recurrent experiments as well as from the in depth study of the circumstances in which the desired effect of resizing the monetary flow will manifest itself.

Halfway through the previous decade, aiming at developing the areas under strain, the state granted fiscal privileges for the imports of raw materials in order to stimulate different manufacturing activities and thus creating new jobs. Unfortunately, the financial lever did not function because after performing several simple operations (such as repackaging) the imported raw materials were directed towards other areas of the country; the conditions under which the fiscal privileges were granted had not been properly formulated.

The flat tax implemented in 2005 represented a bold step forward which considerably increased the level of fiscal competitiveness of the country and moreover, it did not result in a decrease of the budgetary revenues as various Cassandra had predicted. This measure is actually very popular among the East European countries (and not only) to the point that some countries have brought the flat tax to levels characteristic to tax havens (for example Bulgaria, which implemented in 2008 a flat tax amounting to 10%). Nevertheless, the positive effects did not reach their full potential as the tax system as whole had not been thoroughly reformed in order to become more simple and transparent.

There are several examples of designing in an improper manner the functioning of some financial levers which had been set up so as to benefit the socio-economic life.

Establishing the objective of the financial policy as well selecting the financial levers aimed at reaching it takes place in the context of an extremely complex system of restrictions made up not only by the socio-economic conditions but also by socio-psychological conditions reflected by a particular standpoint and a certain behaviour of all the individuals in our societies.

The economic conditions represented by the structure of the national economy, the level of development of each sector, the competitiveness on the external markets and the degree of penetration of these markets, the level of human resources’ qualification, the level of research and development and so on, though complex through the multitude of interrelations, may be quantified accurately enough so as to constitute a system of restrictions within
which formulating as properly as possible the objective of a certain financial policy may be possible with the lowest risk coefficient.

We believe that starting with the final year of the previous decade and continuing with this decade of the new millennium, the economic coordinates of the adopted financial policy (also perhaps as a result of the pressure exerted by the IMF and the World Bank) were in general properly assessed and taken into consideration.

Concerning the social environment, the matter is more sensitive: the desired middle class being still in the process of formation and at the same time, a tendency of polarization into an ever richer elite and a considerable segment which slides towards the subsistence level being noticeable. Such social conditions exert a significant pressure, more and more stressful, upon those in charge with designing and implementing financial policies.

In this respect, it is relevant the recurrent postponement of the fiscal obligations of the defaulters. The fear of potential social turbulences, resulted from the bankruptcies of dubious debtors, forces the authorities to adjust in process the initial financial policy. On one hand, the firmness needed to implement the adopted policies is not kept at sufficient levels, and on the other hand, viable alternatives are not come up with (working abroad was not imagined by authorities, but it was ‘invented’ by individuals wanting a stimulating work place, and finally with much happiness it was also adopted by authorities, especially as a result of high foreign currency inflows). The expectations of the population (a large part of which contributing to the public budget) are often influenced by what they see abroad, the living standards of other nations. These expectations are not yet in tune with the efforts that would be needed in order to satisfy them. The transition from the centralised economy to the market economy has cast a shadow – at least at this stage – on the correlation between effects and efforts, the general mindset being much corrupted by an exaggerated focus on the effects. Under such circumstances, the pressure with which the decision makers within the financial policy area have to cope is at the same time stressing and inevitably disruptive. At the same time, it is mandatory to take into account the expertise – in all its aspects – of the decision makers within the financial policy area.

History, both ancient and recent, shows that the success of a financial policy depends to an extremely large extent on the quality of those who formulate and implement it; here we refer not only to the professional
expertise, which can be tested easily and with sufficient accuracy, but also
to their moral profile, their resistance to any kind of pressure and temptation.

The socio-psychological conditions, as an element of the system of
restrictions in which the objective of the financial policy is chosen and the
intervention levers are selected, are not only extremely difficult to measure
and quantify, but also hard to predict (their dynamics displays not just a
more and more rapid rhythm, but also deterring ups and downs). Therefore,
the need to create a multitude of scenarios arises. Easy to obtain with the aid
of the information technologies, they are difficult to explain to the layman
taxpayer who is in the end the provider and receiver of the national funds
and who is ultimately in a democratic system, from his position as a voter,
the final decision maker of any policy, especially in the cases in which the
policy aims at distant objectives in time which require tough present
sacrifices. In such conditions, transparency and the skill to explain with
consistency, coherence and in an easy to grasp manner for the voting masses
become the fundamental conditions for the success of any policy.

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