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AUTOMATIC STABILIZATION - ARGUMENT FOR THE REDUCTION OF DISCRETIONARY MEASURES IN PUBLIC POLICIES

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Abstract: *Fiscal and monetary policy can play an important role in stabilizing the economies of the world, especially during the crisis, but this implies, in particular, discretionism, irreversibility and time discrepancies of implementation. Generally, with reference to the automatic tax stabilizer, the concept of automatic stabilizer is increasingly being rumored amid increased mistrust in discretionary macroeconomic policy to combat or at least mitigate the effects of the global economic and financial crisis. Therefore, this article aims to increase the understanding of the advantages of non-discretionism in public policies, providing a series of arguments in favor of increasing non-discretionaryism in monetary and / or fiscal-budgetary policies.*

Key Words: *macroeconomic policies, automatic stabilizers, discretionary stabilization mechanisms*

JEL Classification: D78; E63; H30

INTRODUCTION

Fiscal policy and monetary policy affect the allocation of resources within and between sectors of national economies. Fiscal and monetary policy influences economic behavior in terms of investment, consumption or saving, but also the level and evolution of production, as well as the functioning of economic cycles.

However, internationally existing fiscal and monetary policies are almost entirely built and operate on a discretionary model. Maybe the rapidity of the reaction in the operation of an automatic stabilizer and the lack of considerable costs to stabilize the cyclical fluctuations of production, implicitly assuring a social counterweight to the effects of the economic crisis, may be less desirable elements for politicians for a more "automatic" functioning of public policies.

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Of course, this can also be due to the lack of confidence in the proper design of automatic stabilizers and distrust in checking and correcting the transmission mechanism of automatic stabilizers, but also some inertia and mechanical, unparticularized judging of realities. For example, in times of recession, the instinctive reaction of tax-budget and monetary authorities is to avoid an increase in public deficits, often to reduce public debt and raise money market interest in the desire to prevent inflation, issues which in fact lead to the aggravation of the initial situation, being pro-cyclical measures.

Macroeconomic policies, and in particular fiscal policy, can be used by governments or monetary authorities as macroeconomic instruments to maintain stability and ensure economic growth, also taking into account the skills of these institutions to properly assess situations and get the best decisions, eliminating as far as possible the decisional errors. At the EMU level, in view of the single monetary policy, the macroeconomic stabilization at the level of each state is entirely a matter of fiscal policy. Fiscal policy is thus seen as an effective macroeconomic stabilization tool against the backdrop of rigidities, imbalances, volatility and shortfalls in the real economy (e.g. price and wage rigidities, exchange rate volatility, underdevelopment of market categories, labor market shortcomings, etc.).

In the context of deeper integration into the European Union (EU), to increase predictability, discipline and monetary and fiscal-budgetary harmonization, Member States are increasingly constrained by building rules to rely heavily on the functioning of automatic stabilizers. Therefore, this article proposes to put forward arguments in favor of implementing as much as possible the automatic stabilization in public policies.

LITERATURE REVIEW

Prior to the recent global economic and financial crisis, the issue of automatic stabilization of economic phenomena and processes was often avoided in discussions, and when approached, there were generally discussions in fiscal policy either on the more robust nature and effects of discretionary fiscal policy (Romer and Romer, 1994; Blanchard and Perotti, 2002) or those of non-discretionary fiscal policy (Van der Noord, 2000; Auerbach, 2002). According to Baunsgaard and Symansky (2009), reducing discretion in fiscal policy allows for an increase in the effectiveness of automatic stabilizers.

Generally speaking, the literature discusses the problem of automatic stabilizers, only from the perspective of automated fiscal stabilizers. Fedelino et al. (2009) considers it important to estimate the amplitude of automatic fiscal stabilizers, in the opinion of the authors, considering the extent to which stabilization stems from discretionary measures or the functioning of automatic stabilization.

Automatic fiscal stabilizers are generally estimated quantitatively over time by their effects on the public budgets of different major countries of the world (for example, US, Follette and Lutz (2010) analyse the effects of automatic stabilizers for 2008-2009).

Beyond the macroeconomic or microeconomic analysis, many studies address the issue of automatic stabilization in relation to the size of the public sector, production volatility or the degree of openness of the economy (Galí, 1994, Auerbach and Hassett, 2002).

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The importance of automatic stabilizers was highlighted by Martner (2000), which noted that an automatic fiscal stabilizer (AFS) contributes to moderating economic growth in times of impetus and stimulating the economy in times of recession, allowing a balanced budget to be achieved in a normal economic environment.

Some authors believe that contemporary monetary policy does not provide sufficient support in the fight against economic and financial crises, and non-discretionary fiscal policy provides for the elimination of implementation lags and the possibility of reversibility in the case of improving the economic cycle, providing a fiscal-budgetary autocorrected response (Baunsgaard and Symansky 2009, pp 1-26; Fedelino, Ivanovna and Horton 2009 pp. 1-15; Follette and Lutz 2010 pp.1-40).

According to Auerbach (2002) and Martner (2000, pp.30-54) automated fiscal stabilizers offer an alternative to discretionary fiscal policy, underlining that revenues (especially those from taxes) are more sensitive to changes in production and economic cycle than spending, proving a better elasticity than these. From the expenditure perspective, only income support, such as unemployment insurance benefits, are automatically adjusted to economic activity adjustments.

For exemple, Girouard and André (2005) show that in the euro area the average elasticity of current primary expenses versus the output gap is -0.11, while the average elasticity of taxes is much higher than the unit and about 0.70 for social security contributions. Thus, the budgetary constraints on the budget have a greater control over spending and lower over the revenue, which is why the fiscal-budgetary rules in general, for the sake of efficiency, focus on limiting public spending. According to Girouard and André (2005), the automatic stabilizer is considered to be the automatic budget response to the change in the budgetary position relative to GDP at a change of 1 percentage point of GDP.

According to Dinga (2011), an AFS must: have an anti-cyclical impact, have a normative character, be a structural element, have an "institutional path" created on which to go, have as a goal the reduction of volatility macroeconomic output, to have the asymmetric shocks absorb, to increase the effectiveness of the macroeconomic forecast.

At the same time, an AFS is an implicit and indirect entity, with a non-symmetrical action characterized by great efficiency in achieving the fiscal policy goals, presenting from the point of view of the economic action a certain economic lag related to the mechanism of transmission of the AFS action on the variable command. According to Dinga (2011), efficacy is a consequence of the structural nature of an AFS, and it is a function that depends on the rate of action and the basis of action, describing through their product the quantitative dimension of the efficacy of an AFS, allowing for substitutability of the two elements.

METHODOLOGY OF RESEARCH

The methodologies for calculating automatic stabilizers are mainly concerned with the analysis of automated fiscal stabilizers, with modest references to automated monetary stabilizers, as well as insufficient literature references that combine the stabilizing effects of monetary and fiscal policy.

In general, the literature focuses on the analysis of automated fiscal stabilizers and uses stabilization simulation models (e.g. investigations of the causal effects of various types of shocks on employment and household disposable

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income) (e.g., Bourguignon, F. and Spadaro, A., 2006) in general on well defined areas of the world (eg USA, EU-15, Austria, Central and Eastern European countries, etc.) using macroeconomic and microeconomic time series (e.g .Dolls, M., Fuest, C. and Peichl, A., 2010), often combined with counterfactual analysis (Dolls et al., 2012).

In monetary policy, the most popular automatic stabilizer is the floating exchange rate (Krugman and Obstfeld, 2003), but it may disrupt the functioning of the automatic fiscal policy stabilization (Mundell, 1963). According to Cerna (2014), monetary aggregate targeting may prove to be an automatic stabilizing feature when the economy is experiencing a negative demand shock, with the central bank demanding to maintain a steady supply of money and implicitly to cut interest rates. In these circumstances, according to the author, an aggregate demand model - the aggregate supply model (AD-AS) - is preferable to allow full employment restoration. At the same time, the Quantitative Easing discretionary tool can be redesigned into the format of an automated instrument, and according to Palley (2014), the asset-based reserve requirements instrument (ABRR), which establishes a link between different classes of assets and the requirements for the establishment of reserves for financial corporations (Ailinca, 2015).

In the Socol and Socol study (2012), automatic stabilizers, referring only to fiscal ones, are estimated and calculated on the one hand by the IMF methodology (aggregated method) and, on the other hand, according to the European Commission methodology, implicit OECD disaggregated method). The difference between the two methods is based on the method of estimating the cyclical budget component. More specifically, the aggregate method estimates the cyclical component as a residual, anticipating the structural budget component, while the European Commission estimates firstly the cyclical budgetary component based on cyclically adjusted revenues and expenditures: $R^{CA}=R(Y^P/Y)^{\varepsilon R}$, $G^{CA}=G(Y^P/Y)^{\varepsilon G}$, and gap=$(Y-Y^P)/Y^P$, where R is the nominal primary income, G is the nominal primary expenditure, Y is the current output, Y^P is the potential output, the gap is the output gap, εR and εG are the elasticity of the revenues, respectively the expenditures on regard to the production gap.

Thus, CAPB= R^{CA}-G^{CA} and CPB=OB-CAPB. Regardless of the methodology, according to Fedelino et al. (2009), the total budget component can be decomposed as follows: OB=CPB+CAPB, where ΔOB=ΔCPB+ΔCAPB, where OB is the total budget component, CAPB is the primary structural balance, and CPB is the cyclical balance. Therefore, according to Socol şi Socol (2012) automatic stabilizers or AS are: AS=ΔCPB=ΔOB-ΔCAPB.

Note that the cyclically adjusted primary balance (CAPB) indicates the underlying tax positions when automatic (cyclical) movements are eliminated. However, cyclical adjustments correct the government revenue and transfers in relation to economic activity cycles, but do not adjust incomes related to asset price developments, resulting in changes to CAPB that are not necessarily linked to fiscal policy actions. Thus, CAPB could be underestimated during the economic contraction phases and overestimated during boom phases (Molteni, 2013).

In the work of Dolls et al. (2012) and Mourre et al. (2013, 2014), the CAB or the cyclically-adjusted budget balance is a residual of the ratio between net lending and GDP and the cyclical budget component (CC). More exactly, $CAB = \frac{D}{Y} - CC = \frac{D}{Y} - \varepsilon \cdot OG = \frac{\bar{D}}{\bar{Y}}$, and CC = ε·OG, where OG is output gap, $OG = (Y - \bar{Y})/\bar{Y}$, $\varepsilon = \frac{d(\frac{D}{Y})}{\frac{dY}{Y}} = \frac{d(\frac{R}{Y})}{\frac{dY}{Y}} - \frac{d(\frac{G}{Y})}{\frac{dY}{Y}}$, ε is the semi-elasticity of the budget, and FM is the fiscal multiplier, which is the extent to which GDP responds to government

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intervention. Therefore, the stabilizing effect on economic activity (AS) is the product of the cyclical component of the general government budget and the fiscal multiplier: SA = CC•FM = OG• ε •FM.

An important methodological dilemma refers to reporting either current GDP or potential GDP, so according to Socol and Socol (2012) the structural budget component should be related to potential GDP, but the European Commission estimates the structural budget component relative to current GDP. In the "Financial State of Romania" project, developed by CCFM "Victor Slăvescu", the structural budget balance of the consolidated general budget is defined by the difference between the total budget revenues adjusted with the total budget revenue elasticity in relation to the GDP gap and the total budgetary expenditures adjusted with the elasticity of total budget expenditure relative to the GDP gap, $sbsc_i^{bgc} = VBT \cdot G_{PIB}^{e_{VBT}} - CBT \cdot G_{PIB}^{e_{CBT}}$, where the GDP gap is the difference between actual and potential GDP. Regardless of the calculation methodology, the different ways of estimating potential GDP imply different results for automated fiscal stabilizers.

The distinction between discretionary and non-discretionary is also approached by Molteni (2013) who considers that the econometric specification is extremely important, and if the econometric model is well-specified, the residue should be a white noise with zero persistence, a hypothesis otherwise implausible for the fiscal variables. In addition, studies using macroeconomic regressions (Bayoumi and Masson, 1995) can not distinguish between the effects of automatic stabilizers and the effects of discretionary fiscal policy measures.

A possible solution to distinguish between automatic and discretionary stabilization is the narrative method used by Romer and Romer (2010) and Devries et al. (2011). This approach aims at identifying exogenous fiscal consolidation episodes based on policy documents and government reports, selecting discretionary changes in government taxes and expenditures, motivated only by the desire to reduce the budget deficit. The analysis could also expand on monetary policy decisions, following monetary policy documents and decisions on inflation controllability. However, this analysis may prove to be extremely laborious and could unnecessarily omit a series of documents or items of interest that could make clear the distinction between discretionary and non-discretionary.

In the study by Coricelli and Fiorito (2013), public spending is automatically and discretionally split on the basis of the cyclical fluctuations. Thus, discretionary spending includes public consumption, public investment, company subsidies, and capital transfers from the government without involving the receipt of any counterparty, while automatic spending includes pensions, wages and transfers on health, childcare, subsistence, but also unemployment and disability benefits. In the same note, Darby and Melitz (2008) show that, in addition to unemployment benefits, also the social spending on health and on elderly support react to the economic cycle in a stabilizing manner, with a high elasticity in relation to production.

In general, the rather automatic behavior of public spending is given by their very high non-discretionary spending relative to discretionary spending. The framing based on acyclical or anti-cyclical behavior can be extended not only to budgetary spending items but also to the revenue expenditure items. Moreover, the same anti-cyclical-acylic classification can allow the selection of monetary instruments with automatic or discretionary conduct.

However, beyond econometric or statistical approaches, this article is based primarily on an abstract and logical analysis without a contextualized concentration of empirical nature, proposing in its analysis the increasing the degree of

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consistency of the concept of automatic stabilizer in the economy and offering as much as possible a personalised interpretation.

RESULTS

To support the use of automatic stabilization, we begin to clarify the concept of the automatic stabilizer (implicitly the sub-species of the automatic fiscal stabilizer) from the description of the stabilizer concept. According to Stiglitz and Walsh (2005), automatic stabilizers allow passive compensation of fluctuations in the economy. According to Auerbach and Feenberg (2000) automatic stabilizers reduce the effects in the economy of the GDP shocks. In the period of economic downturn, automatic stabilizers limit the drop in households' disposable income and temper the reduction of consumer spending, resulting in greater stability of the economy.

Therefore, a stabilizer or regulator of a process or economic phenomenon is a "device" to maintain relatively constant values of the process or economic phenomenon on an economical "circuit" section. The stabilizer must provide protection against variations (rapid increase / rapid decrease) of the followed process or phenomenon and in particular to prevent it "short circuit" or "overheating", ensuring the maintenance of the features of that specific phenomenon or economic process under stabilization. Of course, it is necessary to exceed a certain threshold (ceiling or floor) for automatic triggering of the automatic stabilizer. If the element under the stabilisation process has too low/inadequate values at input to the economic mechanism, the stabilizer may be designed as an amplifier of the flow of the economic substance of that particular element.

The concept of automatic stabilizer (AS) refers to an institutional tool to reduce the gap between the economic cycles of different countries or at the level of the same country to allow a smoother transition between the periods / phases of expansion and contraction of economic activity. This element is extremely important in the context of being a country of the European Union and even of the EMU, more and more often being vehiculated the term of supranational stabilizers.

According to Alter (2009), "Automatic stabilizers are the natural means to reduce variations in economic activity." Eilbott (1966) emphasized that automatic stabilizers are fiscal or monetary mechanisms that automatically increase the flow of income or money to individuals and corporations in periods of recession and which reduce such flows during periods of economic expansion.

The automated fiscal stabilizer is an institutional, structural, anti-cyclical, normative and automatic triggering and non-discretionary action that has the effect of reducing the volatility of macroeconomic output (GDP) (Dinga, 2011 coordinator, pp. 123). Stiglitz and Walsh (2005) believe that automated fiscal stabilizers are taxes that automatically are reduced or the expenditures that are passively increasing when the economic environment worsens. If we consider that taxes are liquidity withdrawals from the economy, and spending is liquidity injections in the economy, the same can be applied to monetary policy. Thus, based on the relationship presented in the article of Bratian, Bucur, Oprean and Tanasescu (2016):

$$|PIBa(t) – PIBp(t)|=K(t)\text{-}B(t)||SBC(t)|\text{-}|SBS(t)|=K(t)*B(t)||Va(t) - Vp(t)| - |Ca(t) – Cp(t)||$$

Can be transform in: $|PIBa(t) – PIBp(t)|=K(t)*B(t)||LWa(t) - LWp(t)| - |LIa(t) – LIp(t)||$

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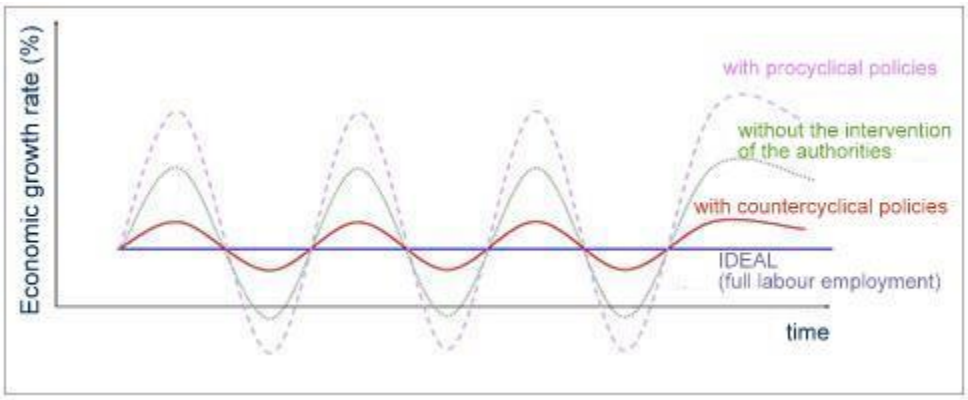
where PIBa = current GDP; PIBp = potential GDP; K = rate of action of AS; B = base of action of AS; Va = budgetary revenue related to current GDP; Vp = budgetary revenue related to potential GDP; Ca = budgetary expenditure related to current GDP; Cp = budgetary expenditure related to potential GDP (the above notations are from Bratian, Bucur, Oprean and Tanasescu, 2016 paper); LWa= liquidity withdrawals from the economy relative to current GDP; LWp= withdrawals of liquidity from the economy in relation to potential GDP; LIa= liquidity insertion into the economy relative to current GDP; LIp= liquidity insertion into the economy relative to potential GDP. On this logic, operations can be kept and continued on the ideas mentioned in the above work.

Of course, the problem is when you can intervene for stabilization and how. As we know, the economic cycle in the recession phase is generally characterized by negative impacts, and economic agents are reducing costs, replacing technologies, reducing personnel, and other measures needed to maintain labor productivity and profit rates. In the boom phase there is an increase in output, the employment rate is relatively satisfactory, credit (especially banking) is more accessible and business is generally prosperous.

In the boom period, monetary policy seeks to curb demand and curb speculative economic activity by raising interest rates, controlling money supply, and curtailing lending, and fiscal policy in order to curb consumption and investment is aimed at reducing public spending and increasing taxation. In this regard, there is the question of how you can achieve a macroeconomic stabilization function so as to maintain as long as possible the boom period, without flattening too much or even bringing, in the desire to stabilize at any cost, in the recession phaze. Thus, automatic stabilization should probably be asymmetric (see Figure 2, compared to Figure 1). More exactly: to restrict very little, but systematically and for as long as possible the economic activity, when the economy is at the peak of economic expansion, and in the recessionary phase to give up as soon as possible and as many benefits as possible from the start of the economic recession, so that the maximum collapse to be severely diminished and to take very little time or even, ideally, the recession phase to be reverse.

Figure 1 - **The Influence of Economic Policies on the Amplitude of Economic Activity Fluctuations and the Possibilities of Automatic Stabilization in Literature**



(Source: Isărescu, 2013)

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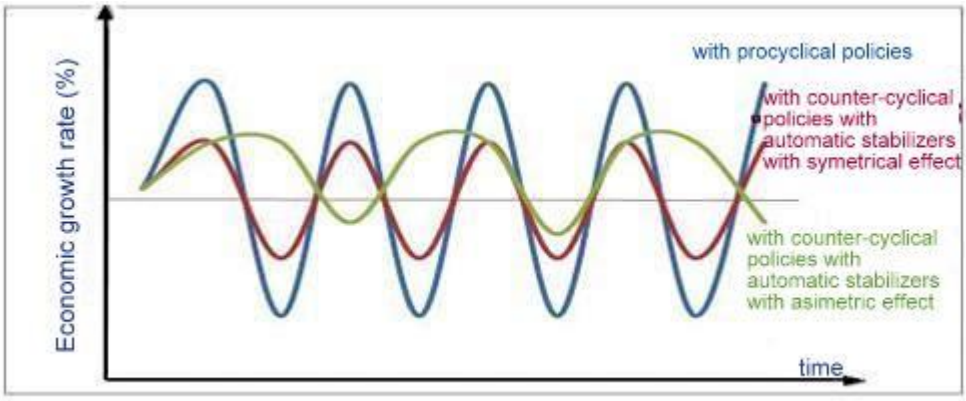
Figure 2 - **The Influence of Economic Policies on the Amplitude of Economic Activity Fluctuations and the Possibilities of Automatic Stabilization in Personal Vision**



(Source: author's conception)

Also, regarding the problem of flattening the positive "peaks", it should be identified, selected and treated only those structural elements that are potentially inflammatory, unsustainable and highly speculative (e.g. the emergence of speculative bubbles in certain areas, an effervescence and increased volatility of the financial market, an increase in indebtedness or a polarized indebtedness in a certain area or branch of the national economy etc.) and not all of the positive "economic" bursts of the economic cycle. This is because some of them are being the result of some inventions, innovations and the introduction of new technologies which do not necessitate flattening. Of course, regardless of whether automatic stabilizers are functioning or not, the literature highlights (e.g. Isărescu, 2013) the fact that, after World War II, the contraction periods of the economic cycle have become shorter and those of expansion longer.

CONCLUSIONS AND RECOMMENDATIONS

Increasing the importance and weight of automatic stabilizers in the economy can act in an anti-cyclical manner, improving general economic conditions and even the proper functioning of other stabilizers (e.g. discretionary ones). Automatic stabilizers contribute to reducing the risks associated with their implementation and maintenance, while allowing for a timely reversal of their effects.

At the same time, there is the problem when it can be intervened to stabilize the economy and how. As we know, the economic cycle in the recession phase is generally characterized by negative effects, and in the boom phase of predominantly positive effects. Boom and recession phases have a normalization function in the sense that: in the recession, some economic imbalances are being restructured (often unavoidably forced), and in expansion it is facilitated to achieve some aspects of material and social welfare. Thus, public policies (both monetary and fiscal) also have different stabilization roles in relation to the two phases. In the boom phase, monetary and fiscal fiscal policies are aimed at curbing the growth of demand and speculation, increasing fiscal and public spending, posing the issue of not paying too much, and in the period

of recession, public institutional mechanisms (including the design of automatic stabilizers) should provide for more benefits and as quickly as possible so that the maximum economic collapse does not occur or be severely diminished.

It should also be pointed out that, for example, macroeconomic policies, be they monetary or fiscal-budgetary, in the boom period, if the dominant element chosen as a stabilization target (e.g. inflation or budget deficit, etc.) is limited to the parameters of whose values are considered to be "normal" in the view of the managers of these policies, there is often no institutional reaction without anticipating a possible trend reversal made by the evolution of other contexts element of less sustainable nature. At the same time, the globalization and liberalization of the capital markets contributes to the increase of the financial and economic cycle amplitude, distorting the possible positive effects on the economic cycle caused by some monetary or fiscal-budgetary policy measures.

At the same time, stimulus by financial-monetary or fiscal-budget ways (e.g. a reduction in direct tax rates) can often prove counterproductive in the sense that economic agents and the public may consider it necessary and more important to repay debts and "repair" the balance sheets and less important to carry out investments, to maintain appropriate and continuous transfers of productive resources and, in general, to stimulate consumption. Thus, the economic behavior of the population, economic and state agents and supranational institutions is an important variable in the evolution or movement of the economic cycle, requiring, in addition to the direct interventions of macroeconomic policy makers also the proper functioning of automatic stabilizers in any country or at regional and world level.

Therefore, deepening research, both in terms of automatic fiscal and monetary stabilization, could be an important step in order to understand and implement of a truly efficient and effective macroeconomic policy mixes.

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