

DISCRETIONARY FISCAL POLICY AND GOING CONCERN PRINCIPLE FOR SMES IN CRITICAL ECONOMIC ENVIRONMENT

Authors:*

Mihaela GÖNDÖR,
Ramona NEAG

A*bstract.* Based on European and Romanian evidence regarding economic and legislative environment, the aim of the present paper is to analyze the impact of the fiscal policy during 2009-2010 on the SME's activity, in terms of the Going Concern Principle in Critical Economic Environment. The objectives of the study are the identification of the possible negative effects of the discretionary fiscal policy in Critical Economic Environment and the identification of the potential solutions from the perspective of non-discretionary fiscal policy. Considering important to clarify some conceptual issues related to discretionary and non-discretionary fiscal policy from the perspective of the Going Concern Principle in critical economic environment, this study is based on logical analysis in principal.

Key Words: Discretionary Fiscal Policy, Nondiscretionary Fiscal Policy, Going Concern, Economic Environment.

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1. Introduction

According to the European statistics (Eurostat, 2011), small and medium-sized enterprises (SMEs) in most European Union countries are now faced with an

* Mihaela Göndör, PhD. Associate Professor, Petru Maior University of Târgu-Mures, Faculty of Economics, Law and Administrative Sciences, email: mihaelagondor@yahoo.com; Ramona Neag, Professor, Petru Maior University of Târgu-Mures, Faculty of Economics, Law and Administrative Sciences, email: ramonaneag@yahoo.com

increase in reported defaults, insolvencies and bankruptcies. According to the Romanian statistics (Insse, 2011), more and more Romanian SMEs have ceased their activities during 2009-2010, claiming excessive taxation, bureaucracy, often changes in fiscal rules, lack of predictability, lack of a coherent policy to encourage the private sector.

Based on these statistics, the aim of the present paper is to analyze the impact of the fiscal policy in Romania during 2009-2010 on the SME's activity, in terms of the Going Concern Principle in Critical Economic Environment, in order to separate the effects of discretionary fiscal policy from those of non-discretionary fiscal policy. The objectives of the study are the identification of the possible negative effects of the discretionary fiscal policy in Critical Economic Environment and the identification of the potential solutions from the perspectives of non-discretionary fiscal policy. The result of this study is the definition of discretionary and non-discretionary fiscal policies.

The main challenges in methodological issues for separating the effects of discretionary fiscal policy from those of non-discretionary fiscal policy derive from the identification problems. The effects could be confounded with each other as well as with other factors since during the dynamic adjustment process the authorities use a wide range of tools belonging to both fiscal and monetary policy, providing output effects together, their separation being almost impossible to do. The present study's methodology is based on the author's opinion that various methods commonly used to estimate such effects, i.e. structural vector auto-regressions (VARs) and model simulations, have different weaknesses in addressing the main challenges mentioned above, for example the difficulty in isolating exogenous movements in taxes or government spending. In consequence, considering important to clarify some conceptual issues related to discretionary and non-discretionary fiscal policy from the perspective of the Going Concern Principle in critical economic environment, this study is based on logical analysis, in principal, and focused on European and Romanian evidence regarding economic and legislative environment in the 2009-2010 period.

This paper is structured as follows: Section 1 embodies the study objectives, the study methodology and the paper structure. Section 2 presents the research status in the study field together with a simple theoretical framework for thinking about discretionary and nondiscretionary in a fiscal policy concept. Section 3 studies the Going Concern Principle for SMEs in Critical Economic Environment. Section 4 analyzes the possible negative effects of the discretionary fiscal policy and the potential non-discretionary fiscal policy solutions and section 5 concludes.

2. From Discretionary to Non-discretionary in Fiscal Policy to Boost the Economic Environment

Reviewing the literature in the research field, the logical conclusion is that the mistrust towards discretionary fiscal policy generated by the present economic crisis has called into question the non discretionary fiscal policy and automatic fiscal stabilizers concepts, increasing the researcher interest in this issue, admitting its huge potential of being an anti-crisis solution. Moreover, the possible revision of the Stability and Growth Pact as regards the subject of fiscal consolidation increases the importance of non discretionary fiscal policy and automatic fiscal stabilizers as a research subject.

According to some researchers (Afonso A., 2009; Sousa R., 2009), fiscal policy can contribute to macroeconomic stability through three main channels:

- The government's deliberate change in public spending and tax instruments to offset business cycle fluctuations;
- The automatic reduction in government saving during downturns and increase during upturns;
- The structure of the tax and transfer system, which can be designed to maximize economic efficiency and market flexibility, enhancing the flexibility of the economy before shocks.

The first channel represents the discretionary fiscal policy and the notion of non-discretionary fiscal policy pertains to the last two channels. The discretionary properties of fiscal policy problem have been a subject in literature before, (e.g., Kennedy N., 2004; Buti M. et al., 2004).

According to some researchers (e.g. Baunsgaard T., Symansky S., 2009; Fedelino A., Horton, M., 2009) the discretionary fiscal policy has at least the following disadvantages: implementation lags, political decision-making process and it is not automatically reversed when the economic cycle changes up or down. Other researchers (Brondolo J., 2009; Follette G., Lutz B., 2010) argue that a non-discretionary fiscal policy do not suffer from these shortcomings, ensuring, in contrast, a prompter and self-correcting fiscal response. As argued in the scientific literature, the non-discretionary fiscal policy may enhance the impact of a fiscal expansion on demand with respect to discretionary action, as the latter may raise solvency concerns and affect interest rates. (Baunsgaard T., Symansky S., 2009). This means that the automatic nature also provides a timely reversal of any fiscal expansion.

Some studies provide quantitative estimates of the effects of the non-discretionary fiscal policy through automatic fiscal stabilizers (AFS) on the government budget and on the economy (Follette G., Lutz B., 2010). There are also studies that provide guidance on how to interpret AFS, clarifying the methodology for decomposing changes in overall fiscal balances into discretionary and “automatic” effects. (Fedelino A, Ivanova A., 2009).

Regarding the Romanian literature, it is to note the contribution in identifying the logical properties of a discretionary public policy and of a non-discretionary public policy, in clarifying the criteria for determining and its identification. (Dinga E., 2009).

The conclusion we can find in such a literature allows us to systematize some characteristics that individualize discretionary and non-discretionary fiscal policy types as it follows:

The characteristics of Discretionary Fiscal Policy (DFP) are:

- DFP means deliberately changing in public spending and tax instruments to offset business cycle fluctuations
- DFP is subject to potentially long inside lags, the delays between recognition of the need for fiscal stimulus or restraint and the design and implementation of the appropriate fiscal measures.
- The delay in resolving of financial sector problems, including prompt closing of insolvent financial institutions, increases the fiscal cost of the crisis.
- Some of these inside lags occur administrative reasons, other inside lags occurs for political reasons.

The characteristics of Non-Discretionary Fiscal Policy (NFP) are:

- Based on automatic fiscal stabilizers (AFS), NFP provides a faster decision making process, without inside lags, ensuring a timely fiscal response.
- Being an automatic process, political decisions are not required so NFP policy is shielded from political interference.
- The structure of the NFP can be designed as a macroeconomic tool in order to maximize economic efficiency and market flexibility, thereby enhancing the flexibility of the economy towards shocks.
- With AFS, implementation is timely and gradual as tax react in a countercyclical manner for changing economic conditions. The fiscal relaxation in crisis time is automatically followed by a fiscal tightening in boom time assuring a lasting optimal fiscal package.

3. The Going Concern Principle for SMEs in a Critical Economic Environment

The going concern principle is the assumption that an entity will remain in business for the foreseeable future. This means the entity will not be forced to stop operations and liquidate its assets in the near future. An SME will prepare financial statements (annual accounts) on a going concern basis unless management either intends to liquidate the entity or to cease operations or has no realistic alternative but to do so. By making the assumption of going concern, the accountants of these SMEs are justified in deferring the recognition of some expenses until a later period, when the entity will presumably still be in business and using its assets and can recognize assets at fair value. The management shall assess the reporting entity's ability to continue as a going concern.

If an SME has a history of profitable activities and easy access to financial resources, the management may conclude that the going concern basis of accounting is appropriate without a complex analysis. In some cases, the management may consider some factors relating to current and expected profitability, debt repayment schedules, and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Management may identify information that indicates there could be substantial doubt about the reporting entity's ability to continue as a going concern. The significance of the information related to conditions and events will depend on circumstances. Some examples of such conditions and events are presented below:

- a. Negative trends in SME's activities, for example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities;
- b. Indications of possible financial difficulties, for example, modifications of usual trade credit from suppliers, restructuring of debt and a need to find new sources of financing or to dispose of assets;
- c. Internal matters, for example, labor difficulties, work stoppages or substantial dependence on the success of a particular project;
- d. External matters that have occurred, for example, uncertainty related to fiscal matters, legislation including fiscal matters that might create difficulties to an entity to operate or to budget its activity.

The assumption of going concern is made by the management, the accountant and the auditor, being subject to a considerable amount of interpretation,

especially in a critical economic environment characterized by high uncertainties. During the present crisis, when SMEs in most of the European Union countries, including Romania, are faced with an increase in reported defaults, insolvencies and bankruptcies, an efficient fiscal policy could be an argument for a going concern of operation at small and medium-sized entity level.

The Notes to financial statements are the documents in which where the management and the accountant could present the assumption of a going concern principle for the SME's activity. So, it is not the balance sheet or the profit and loss account, this is the Notes. In a critical economic environment analysis of key financial ratios could be a solution for identifying the problems faced by the SMEs. Could it be enough? The fiscal policy has a big impact on a SME. Its vulnerability to the changes in fiscal policy is higher as a SME cannot react so easily to these changes. Even the assumption of going concern principle is real, the SMEs cannot predict the changes in fiscal policies or the impact of such changes on its operating activity, budget and future cash-flows. In many cases business owners of SMEs are not financially literate and rely upon their accountant to represent them and their business. Accountants have cemented their status and privileges on the basis of claims that their expertise enables them to mediate uncertainty and construct independent, objective, true and fair financial statements of SME's affairs. The claims of expertise are frequently affected by unexpected SME's collapse, failure and bankruptcy. Such events increase the suspicion that accountants lack the independence, expertise and incentives to present the promised "true and fair view" of the account of SME's affairs. If the collapses and failures are linked to fiscal policies, could be the accountant responsible for the going concern principle assumption? No, we think not. The critical economic environment poses many issues to SMEs to focus on it. Could the fiscal matters be one of them?

4. Discretionary Fiscal Policy and AFS for Improving SME's Economic Environment

When analyzing the fiscal treatment of SMEs it is necessary, on a preliminary basis, to gain insight into the economic, institutional and technological contexts in which these entities are called upon to operate.

In 2009 and 2010, the international financial crisis reached the Romanian economy and rendered the measures taken by the Government of Romania unable to avoid recession, the signs of deterioration of the financial and economic situation being quickly noticeable, i.e. a decrease of economy by over

7% (Insse, 2011). The number of enterprises decreased by 10% in 2010 compared to 2009, and the average number of employees decreased by 6% in the same period (Insse, 2011). The 2009-2010 fiscal packages, in the current circumstances, based on spending decreases, multiples and unexpected tax changes, are likely to have the smaller multipliers both for consumers and for enterprises.

A study made at Romanian level reveals that most of the SMEs that have ceased activity during 2009-2010 claim limited demand, excessive taxation, bureaucracy, often changes in fiscal rules, lack of predictability, lack of credits, lack of a coherent policy to encourage the private sector (The National Trade Register Office, 2011).

A study made at European Union level (EU27) reveals that in 2009-2010 SMEs from all the EU27 countries have faced the same problems, e.g. limited demand, problems with infrastructure, limited access to finance and to new technology, lack of quality management, too expensive labour force and problems with administrative regulations, in the proportion shown in Figure 1 (European Commission, 2010). According to this study, most SMEs claim to be overburdened by administrative regulations considering that the situation has got worse in the past two years.

Figure 1. EU27 SMEs Business Constraints/Difficulties Encountered in 2009-2010 (%)



Source: European Commission, Observatory of European SMEs, 2010.

Based on the results of the European Commission study we can conclude that problems with administrative regulations are a significant constraint for many SMEs in Europe, second only to the problem of reducing customers' purchasing power. Both studies reveal that the fiscal policy can generate significant constraints for SMEs especially in crisis time.

The logical conclusion that the fiscal policy may represent a threat to the entity's ability to continue its activity as a going concern in a critical economic environment became the main assumption of this paper.

The next step is to analyze the characteristics of the administrative regulations claimed by the SMEs as determinants for their inability to continue as a going concern. For this purpose, we will systematize in the first column of Tabel 1 the fiscal issues from the above-mentioned presented studies, having negative effects on SMEs' activity. Next, we analyze the characteristics of the fiscal issues presented in the first column by comparing with the characteristics presented in the second section of this study; then, in order to separate the effects of discretionary fiscal policy from those of non-discretionary fiscal policy we will indicate in the second column of the Table 1 the nature of the fiscal issues. The second part of Table 1 presents the fiscal proposal. Analyzing the characteristics of the fiscal solutions by comparing with the characteristics presented in the second section of this study we indicate the discretionary or non-discretionary nature of fiscal solutions.

For organization reasons, the analysis we propose focuses on regulatory design aspects, i.e. the specification of the most appropriate "tax system" so that the SMEs' tax regime be in accordance with the principles of general application and feasibility, particularly with the Going Concern Principle assumption.

By comparing the fiscal issues having negative effects on SME's activity in terms of Going Concern Principle with the discretionary fiscal policy (DFP) and nondiscretionary fiscal policy (NFP) characteristics, we find the nature of the undesirable national fiscal rules which is of entirely discretionary type (Table 1). In the same way, by comparing the above proposals the current crisis may require as new solutions with discretionary fiscal policy (DFP) and nondiscretionary fiscal policy (NFP), we find the nature of the desirable national fiscal rules which is of almost entirely nondiscretionary type, as in Table 1.

Table 1. The nature of fiscal threats and fiscal solutions in terms of DFP and NFP

I. Fiscal issues having negative effects on SME's activity in terms of Going Concern Principle	The nature of fiscal threats in terms of DFP and NFP
Excessive taxation	DFP
Bureaucracy	DFP
Frequent changes in fiscal rules	DFP
Lack of predictability	DFP
Lack of a coherent policy to encourage the private sector	DFP
II. Fiscal proposal	The nature of fiscal solutions in terms of DFP and NFP
The optimal fiscal package should be timely	NFP
The optimal fiscal package should be large	NFP
The optimal fiscal package should be lasting	NFP
The optimal fiscal package should be diversified	DFP, NFP
The optimal fiscal package should be contingent	NFP
The optimal fiscal package should be collective	NFP
The optimal fiscal package should be sustainable	NFP
The scope of AFS should be increased, which by nature, are countercyclical	NFP
The market confidence should be increased by providing more robust medium-term fiscal frameworks that should cover a period of four to five years, which include:	
- accurate and timely projections of government revenues and expenditures;	NFP
- a government balance sheet reporting data on government assets and liabilities	NFP
- a statement of contingent liabilities and other fiscal risks	NFP
- transparent arrangements for monitoring and reporting fiscal information for the central and local budget, other public sector entities, on a regular and timely basis	NFP
Strengthening fiscal governance	NFP
Independent fiscal councils could help monitor fiscal developments	
Thus increasing fiscal transparency, and could also advise on specific short-term policies or medium-term budgetary frameworks, to reduce the public's perception of possible political biases	
Improving expenditure procedures to ensure that stepped-up public works spending is well directed to raise long-term growth potential.	NFP

Source: Made by authors.

Which are the desirable characteristics for national fiscal rules? For any rule to be successful in delivering desirable outcomes, it has to be predictable and credible. In practice, this requires operationally simple and transparent rules with efficient enforcement mechanisms and sanction systems. Moreover, monitoring the compliance with the rules should be easy and carried out by the SMEs. These characteristics imply an architecture based on simplicity and transparency, on the one hand, and flexibility and contingency, on the other hand. The optimal fiscal package should be timely because in critical economic environment the need for action is immediate; large, because the current and expected decrease in private demand is exceptionally large, requiring fiscal actions for enhancing the flexibility of the economy towards shocks; lasting because the fiscal actions must assure its beneficial effects all over the economic cycle. Acting countercyclically, the fiscal relaxation in crisis time is automatically followed by fiscal tightening in a boom period, assuring a lasting optimal fiscal package. The optimal fiscal package should be diversified because it must cover all the aspects of the crisis; contingent because it should be transparent; collective, since each country that has fiscal space should contribute; sustainable, so as not to lead to a sovereign debt explosion and adverse reactions of financial markets.

For reducing the perception of possible political biases the solution is strengthening fiscal governance. For example, independent fiscal councils could help monitor fiscal developments, thus increasing fiscal transparency, improving expenditure procedures to ensure that public spending is properly directed to raise long-term growth potential. The clarity of fiscal policy together with a strong commitment by policy makers to take action are needed to improve the economic critical environment, are likely to reduce uncertainty, lead consumers to decrease precautionary saving, as well as stop waiting and start spending again. The key challenge for policy-makers in critical economic environment is to prevent entities to cut down their current operations.

As shown in Table 1, the analysis finds that fiscal issues having negative effects on SME's activity in terms of Going Concern Principle are entirely discretionary and the designed solutions are entirely nondiscretionary. The conclusion of such an analysis is that the most appropriate tax system for SMEs in order to make their economic environment be in accordance with the Going Concern Principle is almost entirely nondiscretionary type.

5. Conclusions

Fiscal policy is an important tool for managing the economy because of its ability to affect the business environment. The current design of a national fiscal policy

in Romania is almost entirely of a discretionary type. The effectiveness of using a discretionary fiscal policy depends on policy makers' ability and political interests.

We consider that the fiscal policy can and must be used to deal with "market failure", but in a way that includes, among its features, transparency, responsibility and clear operating mechanisms. By using right incentives, the fiscal policy can have longer-term effects. Moreover, by committing in advance to a specific fiscal policy action contingent on economic developments, uncertainty about the fiscal policy framework during a recession should be reduced. An efficient fiscal policy must give priority to sustainability over time, also being able to adapt the budget balance to the economy movements in a flexible manner. For the SMEs, the transparency and predictability of fiscal rules are the most important elements of the medium-and long-term business plan. Continuing the discretionary fiscal policy in absence of fiscal consolidation will continue to induce the uncertainty to the business SME's environment, delaying Romania's opportunity to overcome the effects of the crisis. Introducing Automatic Fiscal Stabilizer AFS instead of continuous changes in taxation means stable and predictable fiscal legislation along with a transparent enforcement, ensuring a coherent transparent legislative framework, fiscal predictability and stability to investors. Modernizing the fiscal legislation by introducing AFS is an important step ahead that Romania needs to take. A modern fiscal legislation will improve Romania's competitiveness at the regional level, and the benefits will be reflected in the GDP growth, increased revenues and healthier economic environment. This is the reason why we stand for a nondiscretionary fiscal policy, which means known fiscal rules, in order to reduce the economic environmental uncertainty and influence important, immediate and future effects for the SME's decisions, in terms of Going Concern Principle.

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