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Emerging Markets Queries in Finance and Business

The impact of the government revenues and expenditures on the economic growth

Iulia Roșoiu[a,*]

[a]The Bucharest University of Economic Studies, 6, Piata Romana, 1st District, Bucharest, postal code:010374, Romania

Abstract

The purpose of this study is to analyze the impact of the government revenues and government expenditures on the economic growth in Romania, over the period 1998q1 - 2014q1. I use Granger causality test through cointegrated vector autoregression (VAR) methods to determine whether government revenues have or not a more influent role than government expenditures on controlling economy. This is an important aspect to analyze due to the fact that the state uses as a controlling economy instrument the fiscal policy.

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1. Introduction

It is important to analyze the impact of the government revenues and expenditures on the economic growth due to the fact that the state uses as a controlling economy instrument the fiscal policy. Economists analyzed this aspect over different periods of time and for different countries. Although different econometric methods were used, in recent year's vector autoregressive (VAR) models have become the main econometric tool to assess the effects of fiscal and policy shocks. Even if there were used different VAR models specification (set of endogenous and exogenous variables, sample period, country, deterministic terms and lag length) the results regarding the effect of fiscal policy decisions were similar.

* *E-mail address:* iulia.rosoiu@yahoo.com

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The purpose of this research is to analyze the importance of the fiscal policy decisions. Estimating a VAR model, the results will show if it is more important to control the government expenditures, the government revenues or this two variables should be taken into consideration both at the same time. I consider that this is an interesting aspect for an analysis due to the fact that it affects the Romanian population directly. The question is: Is it better adopt a restrictive fiscal policy (it means to decrease the government expenditures and to increase the government revenues – taxes) or an expansive fiscal policy (it means to increase the government expenditures and to decrease the government revenues – taxes) in order to determine an economy growth.

Section 2 presents those conclusions described by other economic analysts. Section 3 describes the time series that I used in order to estimate the VAR model and the variables transformations that the tests indicated. Section 4 explains the econometric methodology used. Section 5 presents the results of the estimation.

2. Literature review

Brașoveanu, I., Brașoveanu Obreja, L. and Păun, C., (2007) had analyzed the correlations that exist between fiscal policy and the main macroeconomic indicators in Romania over the period 1990-2007. For this purpose they had used regression technic, Granger causality and interval analysis. They applied these econometric methodologies using the fallowing variables: the percentage of government revenues in GDP, growth economic rate of real GDP, annual average of interest rate, unemployment rate and the percentage of public debt in GDP. They concluded that total fiscal pressure is in an opposite relation with the real rate of economic growth, the percentage of public debt in GDP, unemployment rate and inflation rate.

The Granger causality indicate that this relation exist between the fallowing variables: unemployment rate and the percentage of government revenues in GDP, economic growth and the percentage of government revenues in GDP, public debt and inflation rate and economic growth and unemployment rate.

It is also important to understand the relation between government revenues and government expenditure due to the fact that they affect together economic growth but also individually.

Chang and Chiang (2009) had analyzed the relation between government revenues and government expenditures for 15 OECD countries over the period 1992-2006. They used panel causality Granger test and they concluded that the relation between these two variables is bidirectional.

Over the years, the economic analysts used different approaches in order to study the way that fiscal policy influences economic growth. Four main identification approaches are distinguished:

- the recursive approach introduced by Sims (1980) and applied to study fiscal shocks by Fatas and Mihov (2001);
- the structural VAR approach proposed by Blanchard and Perotti (2002);
- the sign-restrictions approach developed by Uhlig (2005) and applied to fiscal policy analysis by Mountford and Uhlig (2005);
- the event-study approach introduced by Ramey and Shapiro (1998) to study the effects of large unexpected increases in government defense spending.

3. Data

In the analysis of the impact of the government revenues and expenditures on the economic growth in Romania, quarterly data over the period 1998q1 - 2014q1 is being used. The time series are: government expenditures, government revenues, GDP, harmonized indices of consumer prices and interest rate. Table 1 shows the variables notations used when I estimate the VAR model.