



Fiscal policy and economic growth – prospects and opportunities

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ABSTRACT:

The world today and the contemporary economic system are characterized by two prospective trends – globalization and regional integration. The merging of these trends in a single process would probably mean global integration. For the past few years, we have also experienced a long-lasting economic crisis, which is spread all over the world. Taking into consideration the slow rate of economic growth, the necessity of active participation of the government in the economy and the use of fiscal policy for economic regulation is even more tangible. In this respect, a topical issue is to what extent the use of public spending and taxes will be successful in achieving sustainable economic development and stable economic growth and in building a competitive economy. In the present research the object of analysis is fiscal policy and its subject – the perspectives and opportunities concerning public spending and public revenues. The main goal is to evaluate their impact on economic growth using econometric analysis and comparative analysis between Bulgaria and the other new Member States of the European Union (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia and Romania). The purpose is to justify the necessity of public spending minimization and public revenue optimization to the level ensuring the highest economic growth.

KEYWORDS: public spending; public revenue; government deficit; government surplus; economic growth; global integration; minimization; optimal level.

Introduction

Economic growth over the last years has been slow. This fact presents a real challenge concerning public finances. The aim of all European governments is to optimize public revenue and public spending. The problem of the present day is their management and the common mechanisms of economic growth in the context of a globalizing economy at the beginning of the 21st century. The necessity of government participation in the economy as well as the limits of such participation are one of the main questions and the object of theoretical and empirical economic research.

There are a number of opinions concerning the decrease or increase of the public spending share in Gross Domestic Product. A matter of dispute is also whether a certain increase in public spending will induce higher real economic growth. Over the last years, the prevailing position has been that the state has passed over the boundaries of efficient intervention (using public spending and taxation policy) in the free market mechanism. A report by the World Bank “Fiscal Policy and Economic Growth, Lessons for Eastern Europe and Central Asia” states: “the thesis is confirmed – more efficient public spending, lower fiscal deficits and the broader introduction of flat taxes could increase economic growth” (Gray *et al.*, 2007).

Several studies (e.g., Scully, 2003; 2002; Rahn *et al.*, 1996) have analyzed the connection between optimal taxation, public policy and economic growth. The common conclusion is that the optimal level of public spending leading to the highest economic growth is around one fifth of Gross Domestic Product. Public spending which is not efficiently managed is a prerequisite for economic decrease.

Another analysis (Palda, 1997) focuses on the equal decrease of public spending and taxes, which is going to bring considerable benefit to the population of industrialized countries. According to him, the situation at the moment can be called “fiscal churning”, because people paying taxes and those receiving social benefits from the state in most cases are one and the same people. He estimates that useless public spending in the analyzed countries amounts to several percentage points of GDP.

The relationship between public deficit and economic growth (Alesina and Ardagna, 2009) is analyzed using data on fiscal policy connected with cases of

fiscal stimuli and with cases of fiscal adjustments in OECD countries during the period 1970-2007. Fiscal stimuli based upon tax cuts are more likely to increase real economic growth than those based upon spending increases. As for fiscal adjustments, those based upon spending cuts and no tax increases are more likely to reduce deficits and debt over GDP ratios than those based upon tax increases. In addition, adjustments on the spending side rather than on the tax side are less likely to create recessions.

The debate concerning the interaction between taxation and economic growth has a long history. According to some studies (Widmalm, 2001), the tax structure affects economic growth. Using pooled cross-selection data from 23 OECD countries, the author finds evidence that different kinds of taxes have different effects on real economic growth. Tax progressivity has the most harmful effect on growth. There is some empirical evidence that tax progressivity, measured in terms of the long-run income elasticity of tax revenue, is associated with low economic growth. Specifically, the proportion of tax revenue raised by taxing personal income has a negative correlation with economic growth.

The impact of tax policy on economic growth (Poulson and Kaplan, 2008) inside an endogenous growth model can give rise to long-term real growth, which depends on differences in taxation. The study has found that higher marginal shares of taxes have a negative impact on the economy of various countries. The authors state that a slightly progressive taxation system has a positive impact on growth. Those countries which maintain the increase in the revenue rate in compliance with the increase in the income rate reach higher rates of economic growth.

Transfers in the countries which have higher public spending pursue wrong purposes (Tanzi, Schuknecht, 1999). The authors state that “big governments” create a mechanism to transfer money between different groups of people with winners and losers who are not clearly defined. The government policy concerning taxes and social transfers does not contribute to better distribution and redistribution of the income. Social inequality can be reduced through an even distribution of human capital in society. This can be done with much lower public spending and taxation.

Research in the theory of the connection between taxes or public spending and real economic growth is required. Long ago, Thomas Hobbes described people’s lives without government intervention as “nasty, brutish and short” (Hobbes, 1651). He defends the thesis that laws and order in all countries should be provided by the government. Some government functions, such as

the defense of citizens and their private property, as well as an effective and working legal system should stimulate economic growth. In other words, the ensuring of property rights, the fulfillment of contracts and a stable currency system can lay foundations for a normally functioning free market system.

In this respect, it is necessary to conduct research into the connection between public spending and economic growth using a comparative analysis between Bulgaria and other new Member States of the European Union as regards the following two indices. The aim is to compare total public spending and real economic growth. Detailed data on total public spending in percent of GDP of the analyzed countries for the period 2000–2013 are given in Table 1. Data on real economic growth during this period in the same countries are given in Table 2. Comparing public spending in different countries, it is obvious that the highest level of public spending is in Hungary, where the average level is 49.5% of GDP. The highest level over the entire period of the empirical research in the analyzed countries is in Slovenia in 2013 – 59.7%. The second place is occupied by Hungary with 51.2% in 2002 and 52% in 2006. The highest average public spending level is in Hungary, and the realized average real economic growth rate over the analyzed eleven years is one of the lowest – 1.82%. Slovenia holds the second place concerning the level of public spending, as the country's average level is 47.6% and the highest one was observed in 2013 – 59.7%, when the realized economic growth rate was merely 1.1%.

Other Central European countries – Poland and the Czech Republic – also report high public spending levels as percentage of GDP, accordingly 43.4% and 43.7%, and their economies have the average real economic growth rate of 3.67% and 2.74%. The level of public spending in Malta is also comparatively high – 43.4% of GDP, and the real economic growth rate (average value) over the analyzed fourteen years is the lowest one – 1.55%. The smallest amplitude between the highest and the lowest point of economic growth is in Cyprus – the average growth rate is 1.84% and the level of public spending in the same state is around 41.9% of GDP.

The Baltic States (Lithuania, Latvia and Estonia) have the highest amplitude in terms of the realized economic growth rate. The amplitude in Latvia is almost 30%, with the growth rate reaching 11.2% in 2006 and changing to an economic decline of 17.7% just three years later. Economic growth is realized when public spending is 38.2% of GDP, and decline is evident when public spending is 44.2% of GDP. In 2003, Lithuania realized economic growth of 10.3%, while the level of public spending was as low as 33.2%, and in 2009 the economy declined by almost 15%, while the spending of the government rose

Table 1. Total public spending (% of GDP) 2000/2013¹

Country	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	Average ¹
Bulgaria	41.3	40.6	39.6	39.1	38.6	37.3	34.4	39.8	38.3	40.7	38.1	34.7	35.2	38.3	38.3
Cyprus	36.6	37.7	39.7	44.1	42.0	42.9	42.6	41.2	41.7	45.8	46.4	42.8	42.1	41.4	41.9
Czech Republic	41.6	43.9	45.6	50.0	43.3	42.0	41.0	41.1	44.9	45.9	44.1	42.5	43.8	42.0	43.7
Estonia	36.1	34.8	35.8	34.8	34.0	33.6	33.6	34.4	39.9	45.2	40.6	38.0	39.7	38.9	37.1
Hungary	46.8	47.3	51.2	49.4	48.7	50.2	52.0	50.0	48.8	50.5	49.5	49.9	48.7	49.7	49.5
Latvia	37.3	34.6	35.6	34.8	35.8	35.6	38.2	35.8	38.8	44.2	44.4	38.9	36.6	35.7	37.6
Lithuania	39.1	36.8	34.7	33.2	33.3	33.3	33.6	34.8	37.4	44.0	40.9	42.5	36.1	35.5	36.8
Malta	41.0	43.1	43.2	47.9	45.6	44.6	44.3	42.6	43.5	43.2	42.9	40.9	42.7	42.5	43.4
Poland	41.1	43.8	44.3	44.7	42.6	43.4	43.9	42.2	43.2	44.5	45.4	43.9	42.9	42.2	43.4
Romania	38.6	36.2	35.0	33.5	33.6	33.6	35.5	36.3	38.3	40.6	40.9	39.2	36.4	35.1	36.6
Slovakia	52.1	44.5	45.1	40.1	37.7	38	36.6	34.3	35.0	41.5	40.0	40.6	40.2	41.0	40.5
Slovenia	46.7	47.6	46.3	46.4	45.9	45.3	44.6	42.5	44.1	49.0	50.1	49.8	48.1	59.7	47.6

¹Sources: IMF World Economic Outlook (WEO), 2014; International Monetary Fund, World Economic Outlook Database, April 2014; The World Bank, WDI 2014, http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/introduction

Note: Data last updated on 31.08.2014.

Table 2. Real economic growth (in percentage points) during 2000–2013¹

Country	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	Average ²
Bulgaria	5.7	4.2	4.7	5.5	6.7	6.4	6.5	6.4	6.2	-5.5	0.4	1.8	0.6	0.9	3.61
Cyprus	5.0	4.0	2.1	1.9	4.2	3.9	4.1	5.1	3.6	-1.9	1.1	0.4	-2.4	-5.4	1.84
Czech Republic	4.2	3.1	2.1	3.8	4.7	6.8	7.0	5.7	3.1	-4.7	2.7	1.8	-1.0	-0.9	2.74
Estonia	9.7	6.3	6.6	7.8	6.3	8.9	10.1	7.5	-3.7	-14.3	2.3	9.6	3.9	0.8	4.41
Hungary	4.2	3.7	4.5	3.9	4.8	4.0	3.9	0.1	0.9	-6.8	1.3	1.6	-1.7	1.1	1.82
Latvia	6.1	7.3	7.2	7.6	8.9	10.1	11.2	9.6	-3.3	-17.7	-0.3	5.3	5.2	4.1	4.37
Lithuania	3.3	6.7	6.8	10.3	7.4	7.8	7.8	9.8	2.9	-14.8	1.4	6.0	3.7	3.3	4.46
Malta	n/a	-1.5	2.8	0.1	-0.5	3.7	2.9	4.3	4.1	-2.7	2.3	1.6	0.6	2.4	1.55
Poland	4.3	1.2	1.4	3.9	5.3	3.6	6.2	6.8	5.1	1.6	3.9	4.5	2.0	1.6	3.67
Romania	2.4	5.7	5.1	5.2	8.5	4.2	7.9	6.3	7.3	-6.6	-1.6	2.3	0.6	3.5	3.63
Slovakia	1.4	3.5	4.6	4.8	5.1	6.7	8.3	10.5	5.8	-4.9	4.2	3.0	1.8	0.9	3.98
Slovenia	4.3	2.9	3.8	2.9	4.4	4.0	5.8	6.9	3.6	-8.0	1.4	0.7	-2.5	-1.1	2.07

¹Source: International Monetary Fund, World Economic Outlook Database, April 2014; http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/introduction

Note: Data last updated on 31.08.2014.

by 11% and reached 44%. The clear facts for Estonia are as follows – when public spending is under 34% economic growth is over 10%, and when the level of spending grows up to 45.2% of GDP the decline of the economy is over 14%. During the last year (2013), the levels of public spending in Latvia and Lithuania were as follows: 35.7% and 35.5%. These two countries managed to escape the recession realizing one of the highest economic growth rates in 2013 – respectively 4.1% and 3.3%. This fact shows clearly that high public spending is not a precondition for overcoming the economic crisis.

The same three countries, realizing one of the lowest levels of public spending as a percentage of GDP over the analyzed fourteen years, are the countries with comparatively the highest average economic growth during the same time period. In Lithuania, the level of public spending was 36.8% and the average real growth rate of the economy was one of the highest – 4.46%. In Estonia and Latvia, the average public spending level during the period of 2000-2013 was 37.1% and 37.6% of GDP and the rate of real economic growth was respectively 4.41% and 4.37%.

Romania has one of the lowest levels of average public spending during the same period – only 36.6%. The realized economic growth rate is in the golden middle – 3.63%. Comparing the economic growth realized in the analyzed twelve countries, Lithuania holds the first place – 4.46%. In this country, growth is realized when the average level of public spending is one of the lowest – 36.8% of GDP. In Bulgaria, the average level of public spending during the analyzed period is 38.3% of GDP and the economic growth rate is 3.61%. The highest rate of economic growth in Bulgaria was 6.5% (during the period of 2004-2006), when public spending was also comparatively low – about 38% of GDP during the first two years and as low as 34.4% in 2006. Public spending in Bulgaria during the last three years was less than 39%, but our country also had too modest economic growth – less than 1% in 2012 and 2013.

The main conclusion of the completed comparative analysis of total public spending and real economic growth in the twelve European countries is as follows: higher public spending as a percentage of GDP does not guarantee the achievement of high real economic growth. The highest real economic growth rate (over 4%) during the analyzed period is realized in the countries which have moderate public spending (around 40% of GDP and below).

In particular, using regression analysis on the basis of the lowest squares method we will define the dependence (direct, inverse or non-dependence) between the independent variable, namely, total public spending, and the dependent variable, namely, real economic growth, as well as the strength of

the correlation between the two variables. The dependence between total public spending (in % of GDP) and real economic growth is empirically analyzed using a single-factor regression model calculated in the following way:

$$T = a_1 + a_2G, \tag{1}$$

where: T is real growth of Gross Domestic Product (real economic growth in percentage points);

G – total public spending (in % of GDP);

a_1 and a_2 – equation parameters or regression coefficients.

Table 3. Results1 of the calculation of equation 1

Country	Variable	Regression coefficient	t – statistics	Coefficient of linear correlation Multiple R	Coefficient of determination R – square
Bulgaria	Constant	$a_1 = 26.64$	1.10	0.29	0.086
	G – % of GDP	$a_2 = -0.57$	-0.92		
Cyprus	Constant	$a_1 = 22.26$	3.18	0.68	0.458
	G – % of GDP	$a_2 = - 0.46$	-2.76		
Czech Republic	Constant	$a_1 = 33.17$	1.27	0.35	0.125
	G – % of GDP	$a_2 = - 0.67$	-1.14		
Estonia	Constant	$a_1 = 71.34$	8.05	0.93	0.865
	G – % of GDP	$a_2 = - 1.83$	-7.60		
Hungary	Constant	$a_1 = 24.09$	0.68	0.20	0.040
	G – % of GDP	$a_2 = - 0.44$	-0.62		
Latvia	Constant	$a_1 = 76.57$	4.06	0.79	0.622
	G – % of GDP	$a_2 = - 1.92$	-3.04		
Lithuania	Constant	$a_1 = 67.72$	6.31	0.89	0.795
	G – % of GDP	$a_2 = - 1.73$	-5.92		
Malta	Constant	$a_1 = 16.55$	0.70	0.22	0.049
	G – % of GDP	$a_2 = - 0.34$	-0.64		
Poland	Constant	$a_1 = 33.98$	1.70	0.45	0.200
	G – % of GDP	$a_2 = - 0.69$	-1.50		
Romania	Constant	$a_1 = 48.13$	3.47	0.73	0.529
	G – % of GDP	$a_2 = - 1.21$	-3.18		
Slovakia	Constant	$a_1 = 21.73$	2.54	0.56	0.312
	G – % of GDP	$a_2 = - 0.42$	-2.02		

Continued Table 3.

Country	Variable	Regression coefficient	t – statistics	Coefficient of linear correlation Multiple R	Coefficient of determination R – square
Slovenia	Constant	$a_1 = 60.06$	2.97	0.69	0.471
	G – % of GDP	$a_2 = -1.24$	-2.83		

¹The achieved results are based on the data in Table 1 and Table 2 and the author's calculations with the help of software product Microsoft® Office Excel 2007 and ANOVA (Analysis of Variance).

The results of the calculation of equation 1 indicate that: the simple linear dependence as used in the analysis reveals inverse dependence between the two variables. This is proved by the calculation of the regression coefficients a_1 and a_2 . The regression coefficient is positive when the increase of G (public spending) causes an increase in T (real economic growth). The data in Table 3 above show that the regression coefficient a_2 for all of the analyzed countries is negative.

The conclusion is as follows: the increase in public spending above a certain 'threshold level' caused the decrease in real economic growth during the period 2000-2010. This conclusion is conditional and the 'optimal' level could vary to a great extent for different countries depending on their economic development, public spending efficiency and also their economic and functional structure.

A detailed analysis of the achieved results concerning the dependence between public spending (% of GDP) and the realized real economic growth rate reveals the following tendencies:

Firstly, the increase in total public spending (% of GDP) caused the decrease in economic growth in each of the analyzed twelve countries. This negative tendency is most obvious in Latvia and Lithuania. In these countries, a 1% increase in public spending caused a decrease in real economic growth of respectively 1.92% and 1.73%.

Secondly, this negative dependence between the two variables is confirmed in other countries, too. A 1% increase in public spending caused a decrease in real economic growth in the following countries: Estonia (1.83%), Romania (1.21%) and Slovenia (1.24%).

Thirdly, in four of the analyzed countries (Estonia, Lithuania, Latvia and Romania) the value of the linear correlation coefficient is $R > 0.7$. This value reveals strong dependence between total public spending and real economic growth. In other words, between 69% (Slovenia) and 93% (Estonia) of differences in the economic growth of the analyzed countries during this period are

due to total public spending itself. The determination coefficient (R-square) in the same countries varies between 0.529 and 0.865, i.e., it reveals that in Estonia – 86.5%, in Lithuania – 79.5%, in Latvia – 62.2% and in Romania – 52.9% of changes in economic growth are due to changes in public spending. From 13.5% of changes in real economic growth in Estonia up to 47.1% in Romania are due to other factor variables not included in the regression model.

Fourthly, increase in public spending in Slovenia and Cyprus caused lower negative influence on the realized growth rate, since the correlation coefficient is respectively 0.69 and 0.68. This fact means that in Slovenia 47.1% and in Cyprus – 45.8% of the changes in economic growth were due to the change in the level of public spending.

Fifthly, in three of the analyzed countries (Slovakia, Poland and the Czech Republic) the linear correlation coefficient ($0.3 < R < 0.7$) indicates moderate dependence. In Hungary and in Malta, the correlation coefficient is extremely low and it could be assumed that the result is not statistically significant.

Sixthly, the linear correlation coefficient in Bulgaria is very low and it could be assumed that the result is not statistically significant, i.e., the dependence between the two variables is very poor. A 1% increase in public spending over the last eleven years has caused a decrease in real GDP of 0.57%. In other words, 29% of differences in economic growth between Bulgaria and the other analyzed European countries during this period are due to total public spending itself.

Another important conclusion to be drawn from the regression analysis is as follows: we cannot confirm the thesis that small public spending leads to poor economic productivity and low economic growth. However, the results should not be accepted as absolute for the following reasons:

Firstly, the linear correlation coefficient in Bulgaria, Malta and Hungary is less than 0.3. This fact means that the dependence is not statistically significant and the probability of statistical errors is too high.

Secondly, the achieved results will be more statistically significant if the number of the observations is larger. The analyzed period of eleven years is too short. The final results depend on the decrease or the increase of the time period.

Thirdly, as it has been mentioned, public spending is only one of the factors that influence economic growth. Real economic growth also depends on the taxation system and tax rates, on foreign direct investment, on the inflation rate, etc. If these factors were included in the regression model, its statistical significance would be higher.

The aim of the analysis has been to verify the hypothesis that there is an objective dependence between the level of public spending (as a percentage of GDP) and the realized real economic growth rate. **The hypothesis of the existence of a negative correlation between the two values has been proved.**

Some studies (Rahn, 2010) confirm the fact that there exists an optimal level of public spending. The optimal level of public spending is defined as the point at which government becomes so large that it has a negative impact on real economic growth and the employment situation in a country. The aim is to verify if that “optimum border” of public spending is passed. According to the same research, all of the analyzed countries have public spending (in percentage of GDP) above the optimal amount maximizing real economic growth. That means that all of the twelve analyzed countries are in the downward part of the BARS (*Barro, Armey, Rahn, and Scully*) curve (Gwartney, 1998). The most important conclusions are: firstly, the public sector should be optimized and public spending should be substantially reduced; secondly, at the same time taxes as well as public spending should be much more efficient.

It is possible to verify the necessity of public spending reduction, as its level is compared with the optimal amount defined in a recent study (Magazzino, Forte, 2010). The authors of the study reveal that BARS curves have been found, and the shares of actual public expenditure generally exceed to a considerable degree those related to the maximization of GDP growth. However, great differences do emerge. For the 12 countries examined by means of time series techniques, the difference between the actual level of public spending and the peak of the BARS curve that maximizes economic growth ranges from one country to another. The main factors determining such differences are as follows: different functional structure of public spending; different degree of public spending efficiency; different ways of public spending financing – through higher taxes or state loans.

The importance of economic well-being in different countries or gross domestic product per capita is substantial for possibilities to realize higher real economic growth. The authors analyze the EU-27 during the period 1970-2009. They classify the countries according to GDP per capita. Using five different time series techniques and panel data, they empirically prove the existence of the BARS curve. In accordance with the different technique which is used, the optimum level of public spending as a percentage of GDP ranges from 35.6% to 37.3%. According to the same research, this is considerably below the actual average level of public spending in the European Union – 47.9%.

According to the mentioned analysis, the optimum level of public spending in Malta is between 41.96% and 44.8%. Its average level, according to our analysis, is 43.4%. Public spending in Malta ranges from 41% in 2000 to 47.9% in 2003. This comparison proves that public spending in Malta coincides with the peak of the BARS curve and public spending fosters real economic growth in this country. The optimum public spending for Cyprus is 43.3%. This level is very close to the average level during the time period analyzed in our research, but it is 3% lower than the level of public spending in Cyprus in 2010 – 46.4%.

In Central and Eastern European countries, namely, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia, the optimum level of public spending is between 38.74% and 40% of GDP. If we compare these values with public spending in 2013, it is obvious that all of the analyzed countries, except for Bulgaria, Estonia, Latvia and Lithuania, realize higher public spending than its optimum level. The highest deviation in public spending is in Slovenia – almost 20%. In other words, this means that the Slovenian government should substantially reduce public spending. The Czech Republic and Poland should decrease their public spending by less than 5% in order to reach the optimum level which generates the highest economic growth. In Hungary, public spending as a percentage of GDP should be reduced by more than 5%. In Romania and Slovakia, public spending as a percentage of GDP is close to the optimum level. In the Baltic countries, namely, Latvia, Lithuania and Estonia, public spending in 2013 is lower than the optimal level, that is, less than 38.74% of GDP.

According to the analysis, public spending in Bulgaria in 2013 was 38.3%, which is slightly lower than its optimal level. There is some possibility that public spending will be increased by approximately 0.5%. This is a positive tendency provided that public spending is efficiently used and spent for appropriate purposes, namely, investments in human capital and infrastructure.

It is important to draw attention to the fact that, according to an analysis (Gwartney, *et al.*, 1998), only public investment has a positive effect on the realized economic growth rate. The dependence between public investment and economic growth is positive. The analysis proves that a 1% increase in public investment leads to the increase in the realized real economic growth rate of 0.087%. The emphasis in our analysis is on total public spending and their influence on real economic growth, and the reason is that public investment in Bulgaria over the last fourteen years has been relatively low – around 2% of GDP.

Firstly, high public spending slows down economic growth. The reason is probably the fact that increased public spending leads to higher public deficits and to inflation above the normal levels. The inflation itself also slows down real economic growth.

Secondly, it is important to note that definite public spending (Knack, Keefer, 1995), which ensures property rights and the functioning of the legal economy, increases economic growth. There certainly is the positive influence of a well-functioning legal system, which provides for ensuring of the property rights and the fulfillment of contracts and legal proceedings.

Thirdly, we should be very cautious when we recommend the ‘optimum’ level of public spending, because it is conditional and it also may vary in broad limits according to the individual characteristics of any of the countries under analysis.

In implementing its core functions, the State contributes to the smooth functioning of the market mechanism. Public investment in human capital stimulates economic growth. Better education and higher qualifications of people and qualified health care stimulate the progress of the society and its well-being. Public spending on public administration and bureaucratic institutions as well as on the salaries of the people who work there slows down economic growth. Education and health services can be defined as the core functions of the governments of separate countries. Public spending on education and health is investment in human capital, but this spending should be highly efficient. The private sector proved long ago that it can provide for education and health care of high quality. The investment in infrastructure also stimulates economic growth, but the private sector can provide for it too.

Conclusions

The results obtained from the regression analysis indicate that:

Firstly, the increase in public spending as a percentage of GDP over last fourteen years is not in favor of achieving higher real economic growth.

Secondly, the research proves that higher public spending (% of GDP) causes lower real economic growth.

Thirdly, there is a common reason for the fact that the governments which are bigger and more expensive for taxpayers slow down economic growth. This reason lies in the price paid in the form of taxes, state loans, etc. for higher public spending.

The analysis outlines possibilities to realize higher economic growth in the contemporary globalizing economy:

- Potential economic growth will be reached on condition that the level of public spending is reduced below a definite ‘threshold’ or its ‘optimal’ level is achieved;
- A long-term strategy for increasing public spending efficiency is of major importance. Following this policy the analyzed European countries as well as Bulgaria will achieve higher economic growth and sustainable economic development at the time when the contemporary economic system is characterized by two prospective trends – globalization and regional integration.

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