PROBLEMS OF SECURING PUBLIC REVENUES IN TIMES OF ECONOMIC CRISIS

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***Abstract**: A significant factor in the economic growth of countries in transition was the influx of foreign capital i.e. the global financial market. Development model in transition economies, based on foreign borrowing, with the tolerance of the budget and balance deficit of the current transactions was characteristic for Serbia. After mortgage market crash in the U.S., the world was in crisis whose outcome cannot be predicted, which is compared to the Great Depression that followed the collapse of the New York Stock Exchange in 1929. Measures to mitigate the effects of the financial crisis, taking almost all the countries around the world and the group of countries (G 20, seek solutions for a new world financial order. End of the current crisis and new solutions are in sight. If we know the tax is major state revenue, tax collection, both in the EU and in other countries, including our country, especially is delicate in times of economic crisis.*

***Keywords**: economic crisis, public finances, state interventionism, the budget deficit, transition*

1. INTRODUCTION

World economic history, from the early twentieth century, repeatedly faced with financial crises in a smaller or a larger scale: big recession 1929 - 1933, Latin - American crisis in 1982, the Asian financial crisis in period 1997 - 1998. Rapid globalization of the world economy has increased the frequency and dispersion of such incidents, generating a contagion effect, in the form of waves, which fully exposed the vulnerability of the global financial system. It has become clear that the current financial crisis went global and that the financial and, increasingly, is transferred to the real sector of most countries.

Taxes are inevitable and painful. It is therefore not surprising that the determination of the tax system has always been a subject of great controversy.[1] Simply put, most people would like to see reduced taxes. It is amazing what arguments people use to prove that others had to pay more. History of the taxation is replete with the examples of distorting effects. Because of the tax in Britain from the 17th century introduced to windows, the houses were built without windows. In modern England, there are other examples. Despite the three-wheel vehicles maybe less safe and less expensive than four-wheeled vehicles, the tax on them is significantly lower. In the U.S., favorable depreciation for movable walls has encouraged the construction of office buildings with such walls - even when there is no intention to move them. The effects of taxation are not limited to decisions regarding work, savings, and education spending. Although it is not clear to which extent the tax system affects the decisions of individuals to marry or divorce, income tax strongly encourages two employed individuals with similar incomes that, when choosing whether to marry in December or January, choose for January. When it comes to divorce, the opposite happens. Taxes affect the allocation of resources to research and development and long-term economic growth. They affect not only the level of investments in

[1] N. Gregory Mankiw, *Principi ekonomije*, Ekonomski fakultet Beograd, 2005, p.159

companies, but also the way of investment. It seems to be a lot cheaper for person to invest efforts to reduce its taxes, but to create better projects, or increasing production.
All taxes affect economic behavior. They transfer funds from the individual to the state. As a result, individuals in a way, have to change their behavior. If they do not work anymore, they have to cut spending. They can do more and enjoy less leisure time, more when they work, they would need to decrease consumption. Regardless of how individuals adapt, tax increases lead them in worse position. However, some taxes decrease individual's benefits for each dollar of tax revenue collected from others. Tax policy deals with the determination of tax structures despite minimizing the welfare loss for any amount of collected tax revenues, continuing to achieve other goals of tax policy[2]. Each tax must have an effect on consumption. The goal of a tax is the transfer of purchasing power from the individual to the state. Individuals must reduce consumption of certain goods. Effective tax minimizes welfare loss per unit of generated tax revenue.

2. ECONOMIC RECESSION

Going back to the Great Depression in the thirties, appears the same story: strong loan growth of the twenties with the development of installments buying, followed by the credit contraction in the thirties. It is important, however, that today's wisdom further accuses the Great Depression only to restrictive monetary policy of the thirties, ignoring excessive credit creation in the twenties. Role at which central banks lend to vulnerable private sector banks is referred to as "lender of last resort", so named because the intention was addressing to the central bank for financial reserves can only be accepted if other sources of borrowing by the private sector are completely exhausted. The next step is the transition from the gold standard to what is known as "fiat" money. This step was taken at different times and during that time some countries left, and then returned to the gold standard at different times. The most spectacular abandonment of the gold standard took place in Germany in the 1920, when the German government tried to back up their finances by itself printing more money, largely as a result of the agreement "Economic Consequences of Peace," which was imposed to this country by the end of the First World War.
The story of the American transition from gold to fiat money also begins with the two world wars. As Keynes predicted, the consequences of the peace settlement after the First World War were disastrous. Agreement has contributed to bankruptcy of Germany, hyperinflation and economic collapse. With experience these things firsthand, the plan after World War II was quite different from that after the First World War; restoration, not punishment, was the crucial objective of a policy. A key element of this policy of a renewal was to ensure a stable global regime on money to help all parties to rebuild its economic infrastructure. The architecture for the composition of cash after the Second World War was adopted at a conference in Bretton Woods, American resort, near the end of the war. The structure is quite simple: all major currencies are going to be valorized according to the U.S. dollar at a fixed rate. The value of the U.S. dollar in turn was fixed at the price of $35 per ounce of gold. Fixing combination of all currencies against the U.S. dollar and all dollars against gold effectively put the world's currency composition to an agreed monetary gold standard.[3]

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[2] *Ekonomija javnog sektora*, Joseph E. Stiglitz, Ekonomski fakultet, Beograd, 2004, p. 527
[3] George Cooper, *Uzroci finansijskih kriza* , Masmedia, Zagreb 2009, pp. 57-67

3. UNCONTROLLED MONEY PRINTING

The Bretton Woods system functioned for decades, facilitating the re-industrialization of Europe and Japan. While the government continued to accumulate increasing amounts of American dollars, the United States, due to the Vietnam War, got into deeper and deeper debt. Financing the war was expensive for the government. This can be done in three ways:

1. Taxing citizens
2. Taking cash loans, and
3. Devaluation of the currency (the State is printing money)

At the end of the sixties, it became clear that the U.S. government would have to resort to printing money to be able to repay their debts. The government, which held much of U.S. debt, began to feel what is coming; America has had to devalue its currency, abandoning the fixed exchange rate of $35 per ounce of gold. While the foreign government accumulated more dollars in their reserves, and the U.S. responded by printing more dollars to compensate, economists have begun to talk about "the dollar glut". While the dollar amount was increasing, the amount of gold reserves in the United States was growing. The end result was a rush on the bank of unprecedented scale.

However, the economic damage from price spiral cannot endure indefinitely. The need, that central bank is independent raises sensitive issue because it requires that an institution be, to some degree, beyond democratic control. Have such an important institution without accountability to the democratic process makes it even more important that its separation from the responsibilities and operation parameters are well and widely understood.[4]

Relationships between inflation and deficit spending remain quite firmly. Nobel laureate Joseph Stiglitz cited several moments that led to the latest crisis, but puts the excessive money printing and the deregulation of the banking sector at the forefront[5]. The Midwest is trapped in the jaws of a hyper-debt that has a similar effect as the hyperinflation. The debt erode the tax as well as inflation decreases the value of paper money, forcing people to reduce their standard of living. Hyperinflation and debt are changing the way people think, because they are forced to live from hand to mouth. In period 1997 – 2001, presidents of boards of directors enriched the most (including those of Enron), film and sports super-stars, tycoons and media owners and other celebrities. The effect of over-indebtedness is therefore the same as the impact of hyperinflation: distorts perception of reality, forcing people to be deceptive by the illusions in order to make it easier to face the social and economic decline. Lightweight and soft loans lead people to spend money they do not have. In the U.S., from 1993 to 2004, consumer's borrowing via credit cards, car loans, etc. jump from 800 million to 2.000 billion dollars, which is about 3% of the world economy. In 2006, total indebtedness of Americans was three times the country's GDP.

After the bankruptcy of the largest providers of long-term loans in 2007, the property market was totally distorted. Everyone notice the beginning of disaster. This means that one of the seven U.S. families with children (more than five million families) will be defeated in the great game of monopoly of the U.S. economy.[6]

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[4] G. Cooper, Isto pp. 72-75

[5] "Vanity Fair", NIN 25.12.2008. pp. 44

[6] "*Uzroci finansijskih kriza*", autora George Coopera izdanje MASMEDIA, Zagreb 2009, p. 145

4. MIGRATION OF PRODUCTION FACTORS

Thanks to the low cost and competitiveness China is becoming the world's laboratory, while in other similar countries, the factories are closed. Thus, the competitive prices in China affect the economic situation in the most remote places of the world. For example, *Royal Philips Electronics* in 2002 closed two-thirds of its TV production lines in Mexico and transferred them to China. Ricardo's famous theory of comparative advantage, the heart of the international economy, failed due to combinations of capital and high technology with cheap labor. This formula first applied in China. In fact, China has a great advantage because it has a huge workforce at very low prices. This system is so powerful that overturned the benefit that industrial economy had. It is clearly seen from the analysis of trade relations between China and the United States. The river is flowing through the U.S. to China, creating a surplus of U.S. currency in the trade balance of China. It's yet another paradox. China, a communist country, finances the trade but also the U.S. deficit as an example of the capitalist country.[7]

Demolition of communism can be compared with the melting of the polar ice: cheap labor flooding the global market, re-shaping the economy of the whole continents. However, up to now we have never seen such effects and such interdependence that "rogue economics" have created. The Berlin wall disrupted basic principles of economics so freezing wages in the West led to a decline in consumption. This phenomenon has had a deflationary effect, primarily because workers from Eastern Europe and Russia accepted a much lower wages than Western standards. That is the real cause of the decrease in the first wave of European earnings. Not only Russians and East Europeans enter the global markets, but Chinese and Indians who had worked within the closed economy, so the supply of labor in '90s was twice as high.

Richard Friedman said that Chinese wages doubled every 10 years, as it did in '90s, and China will reach the current level of industrial countries for thirty years. The process of accepting labor from other countries could take longer, but the transition could be completed in 40 to 50 years when salaries in the West could rise again, because it would be reached a balance between capital and labor again.

The irony lies in the fact that the middle class, the core of Western democracy, is not weaken due to the wave of communism. On the contrary, it has been pushed into poverty because of the collapse of communist regimes in the East. That is the communist curse.[8]

5. TAX HAVENS AND THE USAGE OF PREFERENTIAL ACCOUNTS

In recent years, tax havens have become major financial centers through which capital flows are taking place in world economics. However, at the same time, tax havens have become a means for illegal tax evasion, money laundering gained by crime and financing of terrorism, which is why the OECD, the EU and the U.S. have taken regulatory measures and actions to combat these illegal activities. At the G20 summit of leaders of the world's largest economies, held April 2009 in London, one of the main topics was the use of measures against non-cooperative jurisdictions and tax havens, and the removing the bank secrecy. Despite different views on the measures to be implemented, G20 leaders agreed it is necessary to protect public finances and international standards of risk posed by uncooperative tax havens. At the summit, an invitation was sent to all the countries that are considered tax havens to adopt international standards for

[7] Napoleoni Loretta, *OLOŠ EKONOMIJA*, *Tamna strana novog svetskog poretka*, Beograd, HESPERIA, 2009, pp. 48-49

[8] Loretta Napoleoni, pp. 45-47

the exchange of information, which were adopted at the G20 summit held in 2004, which have been incorporated in the UN Model Tax Convention.
A new layer of celebrities and billionaires, people who live in a different dimension than ordinary mortals, enjoy benefits of the global economy. The development of transnational capitalism, supported by financial and ambitious speculation, strengthens modern and globalized "leisure class", who kidnaps a portion of the middle class. History warns that extreme difference in income can lead to disastrous consequences. Some of London's neighborhoods, such as, for example, Chelsea, Hampstead, and Belgravia have the highest concentration of billionaires in the world. In 2000, those were the Russian oligarchs, European football players, Chinese and Indian tycoons, actors, TV stars and singers, financiers who over the past 15 years have managed to put in their pockets a huge part of the new wealth. They are the real winners. Rich people of the global era. After 1989, the modern "leisure class" is moving to London to profit from a tax law that dates back to the Victorian era. Grand Woods, former director of the Coutts private bank, with a respectable, aristocratic clientele (the Britain Queen has an account there), explains, “This law was enacted to protect profits plantation owners of the Empire, from the Caribbean in Africa to India. It was enabled them to keep their residence in G. Britain, and to shift tax liability abroad where they performed their activities. Taxable income was only that reported in England and the rest is not subject to taxation. This legislation today uses the new billionaires living in London. British tax system allows those who have grabbed a big chunk of new wealth not to pay taxes in their country. Only Americans cannot derive benefits from this law, because the U.S. tax global incomes of its citizens.[9]

6. PERMANENT PUBLIC DEBT ENLARGEMENT

Modern public finance cannot be imagined without the budget deficit to be covered by borrowing at home and/or abroad. That is the case for centuries. In the third chapter of "The Wealth of Nations", this is titled “The State Debts,” Adam Smith states, “The lack of savings in time of peace leads to a necessity to borrow in time of war. When it comes to war, the state treasury has no money, but the money that is required to cover regular expenses in time of peace. During the war, three to four times the expense is necessary to protect the country, and because of this, three or four times more revenue than the revenue in peacetime. In this emergency, the government has no other source of income other than borrowing. The state that has dealers and manufactures must have a large number of people at any time, which can borrow, even they do not want, a large sum of money to the government. By lending money to the government, they do not diminish even for a moment their ability to continue to carry out their trade and manufacture. On the contrary, they usually increase it. Merchant or capitalist, borrowing money to the state is making money, and instead of decreasing, it increases their business capital." Because of the fact that the seat of government in England is located in the largest commercial city in the world, people who usually lend money to the government are traders.
New taxes (after the war) were introduced solely in order to pay the interest on the money that was lent during the war. It always leads to dissatisfaction of the taxpayers and provokes their opposition. Paying interest on the national debt is the outpouring from one pocket to another. The money doesn’t live the country. Only one part of the income of a group of people is transferred to another group of people, and the people are not poorer. It seems to us that it is quite futile to expect that government revenue can ever completely rid of the debt, or even

[9] Loretta Napoleoni, pp. 68-69

makes some more progress towards that liberation, long as it is a very small surplus of income, or what exceeds the annual expenditure in time of peace.[10]
Discussing case study of public finance, Jovan Lovcevic, in addition to public expenditures and revenue budgets, as the subject to public finance he includes public credit among financial institutions.[11]

7. RESUME

Recent analyzes of the global financial and economic crisis include the possibility that the crisis has touched the bottom itself and the worst situation is behind us. However, since most analysts agree that this crisis will have the shape of the W letter, it is possible we are going to face another decline before the final recovery. Some of the leading officials of financial institutions share this opinion, although they do not exclude the hypothesis that the recovery and the end of the recession may last for several years.
On the basis of previous exposures about the problems of balancing the state budget, both developed and developing countries are facing, especially countries in transition, including Serbia, it is obvious that the provision of needed public revenues has become more complex in recent for two decades: due to economic recession, uncontrolled money printing (from the introduction of floating exchange rates); migration of production factors; phenomenon of tax havens, the emergence of e-money, the usage of privileged accounts; constant increasing of public debt (like a snowball that rolls downhill); abuses in using of budget funds. Solution to the problem cannot be expected in the near future, while the question of the financial flows control at the G 20 level, because, in the age of globalization, no country can solve questions alone.

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