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Budget deficit and government debt as major challenges to public finance in today's economy

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Budget deficit and government debt are two categories of public finance which increasingly tend to be regarded as key indicators of the "health" of an economy. At the same time, their growth is usually judged critically. This article attempts to justify the hypothesis that such an approach cannot be accepted in abstract. Budget deficit and government debt are special cases of credit instruments in an economy. As such, they are intrinsic to today's economy and subject to rules similar to those for credits to households and businesses. Based on the examples of selected countries, it is argued that in this context the main concern is a reasonable management of budget deficit and government debt, comprised within the "credit worthiness" of a state.

Introduction

Budget deficit and government debt, two closely interrelated categories, are characteristic attributes of many national economies, both developed and developing. The source of budget deficit and the resulting public debt is the development of state interventionism which, in recent decades, has often been referred to as stabilization policy. This policy consists of two substantive areas, namely two main goals. These are: a) counteracting economic fluctuations, in particular crises, b) redistributive interventionism which reduces disproportions in the distribution of a product manufactured whose instrumentation consists of an extensive system of social benefits (transfers).

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Stabilization actions in an economic situation have been applied on a relatively large scale since the Great Depression at the turn of the twenties in the last century. Their legitimacy was once justified by J.M. Keynes. Although today it is sometimes challenged on the basis of liberal and neo-liberal economics, in practice anti-crisis intervention is still relatively commonly used. This is proved by the facts relating to the behaviour of public authority (governments) in many countries, particularly in relation to the financial sector (banks) during the last crisis which was initiated on a global scale in 2007.

The second goal, i.e. redistribution of GDP, is associated with the doctrine of the welfare state, or (i) the social market economy implemented in some countries, especially in Europe[1]. The final goal of this area of interventionism is a normatively defined principle of social justice. In practice, according to assumptions, its use is to be translated into social peace and reduction of conflict.

Regardless of the area of intervention actions, budget deficit and government debt mean the achievement of the goals set by the public authority on a scale beyond its own income, i.e. on credit. In this context, a series of questions and doubts arise about the public authority's legitimacy in financing the goals' socio-economic policy from credit.

The homeland of the doctrine of the welfare state is in the Scandinavian countries, while the FRG is homeland to social market economy. Currently, in most European countries belonging to the "old" EU there are hybrid systems, that is a mixture of welfare state and social market economy. In the countries of "new" EU the hybrid is also complemented by the remains of the previous systems.

Indeed, such actions often burden future generations. The responsibility of public authorities for any mistakes in the use of the a credit instrument is also debatable. But apart from these and other disputable dilemmas which have a non-economic dimension (political, ethical or legal), it should be admitted that all activities of governments (public authorities), if conducive to the development of the economy, are justified from the economic point of view. This axiom also comprises the conduct by public authority of a stabilization policy on credit

By adopting this assumption, it can be concluded that the use by the public authority of the credit financing of the achievement of goals of the stabilization policy is formally comprised in the canons of modern economies, because

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credit is a common instrument of today's economy. This benefits businesses, consumers and other institutions of social and economic life. So why could the public authority not use this instrument?

The consequence of the reasoning outlined above is adoption of the following proposition for justification in this article:

Budget deficit and public debt understood instrumentally as a credit, are subject to the universal rules/disciplines of credit functioning:

A) Borrowing is justified if it provides achievement of intended goals, and thus may not be viewed positively or negatively in abstract.
B) A debtor may not take a credit beyond measure, that is beyond its pay-off capability.

The two-fold proposition mentioned above seems to be trivial and obvious, if it is applied to businesses and consumers. When a state (public authority) is the decision maker (debtor), the situation becomes complex. The main reason for this complexity is the fact that the economic rationality in the state action is all too often replaced by normative (political) rationality criteria. In conclusion, it can be assumed that the main purpose of discourse associated with the presented proposition is to check whether a public authority applies a credit instrument in implementing a stabilization policy according to the canons of market economy, and the nature of the instrument

1.1. The scale of the problem

A review of statistical data shows that budget deficit and government debt are a common practice in the conduct of stabilization policy by governments. Tab. 1.1 shows how this problem develops in those OECD countries which joined the organization before 2010. Among OECD members there is virtually no country where the mentioned credit instruments of conducting a stabilization policy of a state would not be used. However, a wide variation in both the level of budget deficit and general government debt is characteristic of each country.

Four countries where a system of welfare state operates, Denmark, Finland, Norway and Sweden, are a special case of the development of budget deficit and general government debt. Taking into account the extent of social benefits in those countries, in their case one would expect a high level of general government debt. However, in 2010 in the four mentioned countries no debt, but an accumulated surplus, was observed in net terms, which was reflected in the negative values of the general government net debt. It is true that in Denmark this surplus was small, but in Finland and Sweden it remained significant, while Norway was characterized by an unusually high level: it amounted to almost 157% of GDP in that year. At the same time general government gross debt was observed in those countries, not specially high, but still at a noticeable level. The differences in the development of general government debt in gross and net terms, and the absence of debt in the latter sense, discussed here, above all testify to a largely instrumental treatment of general government gross debt, and thus budget deficit. In the language of corporate finance, one could conclude that the Nordic countries ensure the "financial liquidity" of their stabilization policies through the use of instruments of credit, although the realization of the objectives of this policy does not in fact require incurring debt. In longer periods governments in those countries have their own means, and with a surplus for the implementation of their policy. In particular, the issue is confirmed in the case of Norway, mentioned earlier. In 2010 – as indicated – together with high surplus, but not debt revealed in terms of general government net debt, there is a relatively high general government gross debt and a very high budget surplus, amounting to almost 11% of GDP. Unfortunately, not all countries are in such a favourable situation as the Scandinavian ones. In many countries, both the general government debt in gross and net terms is high and represents a serious problem. (See: Table 1.1).

Table 1.1. Budget deficit and general government debt by OECD countries in 2010

	Country	Budget deficit	General government debt	% of GDP (a) % of GDP Gross net
1.	Australia	-4.95	20.52	4.39
2.	Austria	-4.62	72.33	52.54
3.	Belgium	-4.08	96.67	81.15
4.	Canada	-5.56	83.95	32.22
5.	Czech Republic	-4.66	38.54	..
6.	Denmark	-2.92	43.65	-1.03
7.	Finland	-2.77	48.38	-64.49
8.	France	-7.08	82.33	76.50
9.	Germany	-3.30	83.96	57.55
10.	Greece	10.42	142.76	142.76
11.	Hungary	-2.25	80.20	74.76
12.	Iceland	-5.41	92.37	62.59
13.	Ireland	-31.98	94.92	78.04
14.	Italy	-4.48	118.99	99.35
15.	Japan	-9.22	220.00	117.24

Table 1.1. Cd. Budget deficit and general government debt by OECD countries in 2010

	Country	Budget deficit	General government debt	% of GDP (a) % of GDP Gross net
16.	Korea South	1.69	33.44	32.11
17.	Luxembourg	-1.71	18.42	..
18.	Mexico	-4.31	42.92	39.31
19.	Netherlands	-5.34	63.67	27.66
20.	New Zealand	-5.80	32.03	3.32
21.	Norway	10.93	55.42	-156.99
22.	Poland	-7.85	54.98	21.35
23.	Portugal	-9.14	92.92	88.70
24.	Slovak Republic	-7.90	41.78	..
25.	Spain	-9.24	60.12	48.75
26.	Sweden	-0.34	39.70	-21.53
27.	Switzerland	0.36	54.52	52.81
28.	Turkey	-2.87	42.15	35.96
29.	United Kingdom	-10.21	75.50	67.68
30.	United States	-10.33	94.36	68.34

a) Budget deficit was calculated as general government net lending/borrowing.
Source: International Monetary Fund, World Economic Outlook Database 2011.

1.2. Budget deficit and general government debt versus economic growth

It is commonly believed that budget deficit and general government debt are justified if they are used for investments, including construction of the socio-economic infrastructure. State expenditure on current targets should be covered from current income – this is a textbook, so-called golden rule, of public finance. However without going into the details of the structure of both budget deficit and general government debt, the above interpretation can be reduced to another, substitution statement. Namely, the use of budget deficit and general government debt in the implementation of a stabilization policy is as much justified as these instruments can help to achieve the objectives of economic growth.

The Author of this paper participated in research whose aim was to verify the hypothesis that budget deficit is inextricably linked to the development of the GDP level, i.e. the basic measure of economic growth. The research also took into account the relationship between budget deficit and the level of investment, which is the main driver of economic growth. The research involved 13 countries of Eastern Europe and the years 1992-2011. These were the countries that in the period under research underwent historic transformation from the system of real socialism to market economy or initiated this transformation and are still in progress.

The results of the research, in particular the Granger causality test, confirmed that, in the countries under research, economic growth was inextricably linked with the increase of budget deficit[2]. Therefore, it can be stated, contrary to some authors' views, that budget deficit in the countries under research over the period examined was not a factor inhibitory to economic growth. On the contrary, the relationship between macroeconomic parameters examined was positive. (See: M. Wiśniewska, J. Wiśniewski, 2012). The level of budget deficit in those countries was, however, formed on the basis of the priority of budget equilibrium. It did not grow during economic downturns – as expected – but showed a decreasing tendency, similar to GDP and investment. This means that governments (public authorities) in the countries examined did not finance loss in private investment with budget deficit during economic downturn.

The same thing happened with outflows: in relation to the year 2000, at the end of 2009 they amounted to 93%. However, in relation to 2007, their fall was even larger and amounted to more than half. (See Tab. 1.1).

As early as the second half of the nineteenth century, a budget deficit, which amounted to a cumulative value of 991 million USD occurred in the United States. In turn, the beginning of the twentieth century was generally free of budget deficit, excluding the years 1917 to 1919. During that period, the cumulative (total) deficit reached more than 23 thousand million USD, and was no doubt due to the participation of United States in World War I. From 1920 to 1930 once again there was no budget deficit. In connection with the Great Depression, from 1931 however, the state, intensifying intervention actions, returned to finance its spending from deficit. And it was from that time until 2011, that years with no deficits were rare. In this 70-year period there were only eight such years. In particular, a deficit at an unprecedented level occurred in the years 2009-2011. In that period, its average per annum was more than 1300 thousand million USD. (See: www. whitehouse.gov).

The almost non-stop presence of budget deficit in the United States since the Great Depression to the present, assumes a particular meaning, especially when it comes to the period after World War II. There is a widespread opinion that government policy in the United States after World War II has remained based on the principles of economic liberalism. However, budget deficit and the ensuing general government debt have been characterized by a continued

[2] Detailed results are published in the article: M. Wiśniewska, J. Wiśniewski, *Budget Deficit in Eastern European Countries and Its Implications*, [in:] *United Europe: Prospects of Development*, 2012, Ministry of Education and Sciences of Ukraine, National Mining University, Dnepropetrovsk.

upward trend in this period. This means that there has been an increasing involvement of the state (public authority) in the intervention activities.

Without going into controversy over liberalism or statism in the United States, it must be concluded that it is an undisputed that for decades that country has used relatively large-scale credit instruments of conducting stabilization policy. At the same time, this policy and the budget deficit and the general government debt have not prevented the building of the world's largest economy in the United States. On the other hand, however, it should be noted that the current state of the debt, owing to its high level, may threaten the developmental dynamics of the United States' economy in the coming years.

Recently, however, research results are also found according to which the impact on economic growth of credit instruments in the conducting of a stabilization policy is not unambiguous. One of the examples in this regard is a study conducted on a period of almost 200 years as exemplified by forty-four countries. The authors of that study argue that over long periods of general government, debt at the level of 60% of GDP lowers the GDP growth by 1%. However, an increase in the debt above this level has an even stronger effect, and so at an accelerated rate, reduces opportunities for economic growth. (See: Reinhart C.M. and Rogoff K.S., January 2010, compare: Alper C.E. and Forni L., August 2011).

1.3. Excessive budget deficit and general government debt, and incapacity of their regulation

As stated at the end of paragraph 1 in this paper: general government debt is a serious problem in many countries. This is related to the debt trap which the economy is not able to repay. Among OECD countries, the most difficult situation is in Greece. In that country, in 2010, both gross and net general government debt was at a very high level, more than 140% of GDP. This was accompanied by a very high level of budget deficit (more than 10% of GDP), which meant a further deepening of the debt disaster. (See: Table 1.1).

A difficult debt situation is also found in Japan. Although it is a country with substantial reserves, which, inter alia, is testified by the fact that general government net debt is just over half of gross debt, which means that it is much lower. Nevertheless, even this relatively lower net debt, not to mention the gross debt, is very high. The difficult debt situation in that country is also reduced by a low interest rate policy used by the Central Bank of Japan (0.1-0.2%) which causes a low cost of debt servicing. Regardless of all the circumstances, this cheap debt will have to be repaid.

The case of Japan, a country being for decades a "development engine" of the world economy, is not isolated. Apart from Greece, a number of other European Union countries are in a difficult situation when it comes to debt. Portugal, Belgium, Hungary and Ireland, are countries facing a spiral of debt. Incidentally, in 2010 Ireland had an unprecedented, even disastrous, budget deficit which was equal to almost 32% of GDP. Not only, however, smaller countries, but also large EU countries are indebted beyond measure. The worst situation in this group of countries is in Italy, France, and Great Britain. FRG, a country that for decades had no problems with general government debt, in recent years has also been affected by the "disease" of debt. As is shown by the latest statistics, in the first three above-mentioned large EU countries, gross government debt showed a continuous upward trend in recent years, up to 2012 inclusive. Finally, at the end of 2012, the debt was: in Italy – 127,0%, France – 90,2%, the UK – 84,26% and FRG – 81,9% of GDP. (See: Government Gross Debt as Percent of GDP by Country, Eurostat 14.06.2013).

The high general government debt in EU countries constitutes a clear acknowledgment of the incapacity of formal regulations functioning in the organization. The treaty concluded in 1992 in Maastricht, which imposes restrictions of not exceeding a budget deficit of 3% of GDP and debt at 60% of GDP is in fact not so much out of order, as simply inactive. Both the majority of the participants of the monetary union as well as most other EU members do not comply with its restrictions/limits. One of the reasons for this state of affairs is withdrawal of France and the FRG in 2003 from the application of penalties for exceeding the normative limit the budget deficit. This was an incident which to date has resulted in the abandoning of the penalties provided for by the Treaty of Maastricht.

Streszczenie

Deficyt budżetowy i dług publiczny jako główne wyzwania finansów publicznych we współczesnej gospodarce

Deficyt budżetowy i dług publiczny stanowią dwie kategorie finansów publicznych, które zazwyczaj traktuje się jako wskaźniki określające „stan zdrowia" gospodarki. Ich wzrost z reguły uznaje się za pogorszenie tego stanu. W opracowaniu podjęto próbę argumentacji hipotezy, iż powyższe twierdzenie nie może być zaakceptowane *in abstracto*. Deficyt budżetowy i dług publiczny stanowią szczególne przypadki instrumentów kredytowych we współczesnej gospodarce. Jako takie odgrywają w gospodarkach narodowych podobną rolę do kredytów gospodarstw domowych oraz przedsiębiorstw.

Opierając się na przykładach wybranych krajów argumentuje się w opracowaniu, że zasadniczym problemem nie jest zadłużanie się państwa. Kredyty są bowiem atrybutem naturalnym współczesnej gospodarki. Tym problemem pozostaje natomiast odpowiednie, przynoszące realizację pożądanych celów rozwojowych, zarządzanie deficytem budżetowym i długiem publicznym.

Summary

The generally positive impact of budget deficit and government debt on the objectives of stabilization policy, particularly on economic growth, has caused widespread use of these credit instruments. At the same time, a relatively easy access to them has contributed to their abuse. It can be concluded that the main pathology resulting from this abuse is the indebting of many countries by a public authority beyond measure, beyond the capability of repaying the resulting debt. Therefore, a continued use of these instruments in countries that have abused them means destructive, not pro-development, actions. In summary, it should be stated that not only at the micro level, but also in scale of a national economy as a whole, credit management should be in accordance with the canons of the market economy and also the nature of credits.

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