Budget deficits and public debt

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Abstract: *In the recent decades, the budget deficit has become one of the characteristics of national economies. Furthermore, it finds its dimensions amplification. Despite this, more and more are the economists who dispute the need to balance the budget, arguing the need even the deficit and systematic use of in order to achieve economic equilibrium.*

Such guidance is substantiated by the need to promote an economic policy which ensures full use of resources and non-inflation economic growth. In these circumstances, balancing the budget is clearly of secondary importance. Such guidance is substantiated by the need to promote an economic policy which en sures full use of resources and non inflation economic growth. In these circumstances, balancing the budget is clearly of secondary importance.

In this context, it supported the need to increase expenditure at a pace faster than income growth and, implicitly, to keep budget deficits

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Governments resort to borrowing to complete the necessary financial resources to cover needs for temporary or longer term. Often, the state obliges them to cover the budget deficit.

Shares management budget deficits depend on their source. There are voluntary deficits which, depending on the type of resources used to finance them, may have a non - cyclic beneficial influence.

How are produce deficits voluntary? When demand of the consumer is weak, an injection of government with monetary means that through the budget, emphasized the revival of public spending, resulting deficit. This may occur automatically, however, when growth slows, tax efficiency is reduced. Such a deficit occurs automatically, without to increase public spending.

Deficit may have a non-cyclic effect if

public spending increases lead to an increase in taxation, which tends to cancel the deficit, provided that entrepreneurs can increase production, otherwise, the deficit creates inflation.

Deficit involuntarily appears when the government fails to curb inflation faster than envisaged in the draft budget. Tax revenues grow more slowly than had been expected. Deficit that appears is not the effect of bad management of the economy, but the success of anti -inflation policy.

A case of unintentionally deficit is the support deficit. To reduce the budget deficit and to provoke a restart, the government diminishes spending and reduces certain taxes. This latter measure not involve reopening immediately, while reducing costs acts faster triggering phenomena of underemployment and reduced demand. Deficit increases. If in these circumstances, the government refuses to finance the deficit through the creation of currency and use the loan, interest rate increases.

This blocks the effect of the revival of public spending, but increases, in turn, the public debt. Thus the deficit is maintaining him.

Recording of some deviations from preset levels for spending and revenue, and thus to initial balance cam results in real processes, which determine whether or not the achievement of revenue and expenditure, but also in construction of the state budget. Therefore, balances, deficits and surpluses may occur either in the budget preparation process, either in budget implementation, due to reported irregularities in projected expenditures. Clearly, however, crucial role in ensuring we have the budget balance economic factors arising in the first instance of the edge quality of production materials. [1]

[1] **Ion Bucur**, *Basics of macroeconomics*, p. 203

State budget deficit may be caused by changing economic conditions, the transition economy through a period of economic recession. The same effect will be obtained due to substantial increases in government spending and / or reducing taxes. In the latter case, the budget variance is determined by changes in the budgetary policy.

Subordination of methods and instruments need to objectives of economic policy requires a concrete analysis of the research budget balance, explaining its content, interpretation of differential surpluses or reliance strategy of balancing the budget. They should be examined in the light of their consequences on the national economy.

Thus, the emergence of budget surpluses reflects some deviations from the estimate situation, but with positive or negative effects. In principle, the budget surplus may be the consequence of achieving higher revenue from those envisaged when designing the budget or non realization costs at default. Assessment of these situations must be made from analysis of the causes generating, content material of the budget surplus, its share in total budgetary revenues, the relationship between economic status and budgetary situation.

Budget deficits are those around who have outlined numerous theoretical controversies, but different options in relation to arrangements for the foundation of strategies for balancing the budget. They should be examined in the light of their consequences on the economy.

Typically, reducing the budget deficit requires a reduction of expenditure, an increase in revenue or a combination thereof. Any increase or decrease of the tax levels should be studied through the effects of long and short.

Level higher or lower of taxes will influence both the supply of saved funds and the demand for such funds. In the budget deficit widened to create conditions for absorption in a high proportion of the volume of funds saved in the society.

The consequences of deficit on the economy are closely related to monetary issues. To finance the deficit, the use of loans, and thus creating money, big money in circulation contributing to increased inflation.

Increasing the budget deficit may contribute to boosting economic activity, because the transition from balance to imbalance contributes to the stimulation of additional beneficial effects on the level of employment and income.

Meanwhile, the existence of large budget deficits put its footprint on the possibilities of financing investment projects. Higher interest payments on loans made by the state to finance budget deficits contribute to reducing the future capital stock and hence on future investment resources.

Also, budget deficits fuel the national debt of some countries, the proportion being determined by the amount of state borrowing to finance them, and afferent interest.

When expenditures exceed revenues, to cover the budget deficit, state appeal to public credit, taking loans or attracting available to the temporarily available cash incomes of the population. State loans shall bear interest payment and loan repayment being made on account of budgetary revenues, mainly due to taxes.

Resources deployed on the public credit, ranks second, after taxes, in procuring the necessary resources to cover expenses. Between government expenditure, loans and taxes there is a close interdependence. To cover the ever increasing expenditure, the loan contracts, and resources necessary to purchase and repayment of loans to pay interest and fees related to use of credits. Debt, as a method of covering the expenses, appeared too many centuries ago. In the XVIIIth century the great age begins loans through issuance of bonds, securities being placed on scholarship.

Government debt is all internal and external obligations of the State, at a time, from loans contracted directly or guaranteed by the Government through the Ministry of Finance, on behalf of Romania, on financial markets. [2].

In general, the public debt comprises total loan amount taken by the state, territorial-administrative units and other institutions of public law and grants at a time, regardless of their eligible date. It called the national debt and includes the same debt from individuals and legal entities. Debt may be internal, when loans are contracted from the inside and external debt incurred from borrowing from abroad.

In another definition, the national debt would only include loans made by the state. In this sense, it would represent amounts accrued by the government had borrowed in the past to finance deficits.

Public Debt is by its very nature an instrument of action of public policies and entered in the analysis of state intervention in economic life. Therefore, instead of public debt should be placed in the context of major economic aggregates, as a result of budgetary and fiscal policy.

The detailed definition and evaluation of government debt varies from country to country. In general, debt means all loans

[2] Law regarding public debt no. 313/2004, art.2.

made by the state. It appears as if the consolidated debt is tracked long-term and floating debt, short-term. The set of commitments to other states or foreign financial institutions is external debt.

In some countries it can be determine the debt of the state (central), and others committed all government (state, local, etc.) or of the public sector in their entirety.

It is necessary therefore to determine an operational concept of public debt to satisfy the requirements of its use as a variable for economic policy action.

The size of debt on a country can be expressed by several indicators: the absolute size and average per capita, the ratio of debt to GDP, debt service (including expenditure on debt repayment itself and with the interest payments).

Debt is affected by many factors: the rate of growth, the interest rate, the future development of budgetary policy, demographic factors, etc.:

Government debt has been an upward trend in both the developed and the developing countries. Thus, in the past 70 years, public debt has increased in the U.S. 500 times (representing three quarters of national income) and 75 times in England (exceeding national income). In all developed countries, government debt varies between 13% and 95% of GDP[3].

Relevant aspects of the debt result from the investigation of its structure and content. If for developed countries preponderant debt is internal, in some developing countries has the share of external debt principal. External debt of a country refers to the debt from some foreign creditors, both public and private. To examine its use indicators: average size of external debt per capita, the ratio of external debt and GDP, external debt service, which includes repayment of loans and interest payments.

In the early 80's, some countries were unable to pay the external debt as a result of large loans made in U.S. dollars For developing countries is triggered phenomenon known as the external debt crisis.

In the ninth decade important changes have occurred in the hierarchy of positions on international creditors. Thus, privileged position of S.U.A. was occupied by Japan, a country which is a creditor of the world. Evolution of public debt of S.U.A. reveals important aspects. Many economists consider that the debt of the'80s has a distinct than in previous periods. By their consequences, the economic crisis of 1929-1933 and the Second World War have contributed to the widening debt. In the U.S., case, these cases were added on the lifting of government and, on the reduction of taxes.

Indeed, reduction of taxes contributed to the increase of disposable incomes and increased opportunities for consumer purchase. However, must be taken into account that, unlike the years'40, the expenditure of the 80 deficiency is not due to current consumption. In the first place, large budget deficits have affected investment in this regard implications have manifested especially in the long term. Secondly, to finance these budget deficits, U.S. has borrowed in foreign forfeiting net creditor position. As a result, in 1985 S.U.A. became a net debtor country in the world, for the first time since 1914.

If the'40 budget deficits due to the large volume of expenditures necessary to support the war in the 80s they were born because the

[3] **Joseph E. Stiglitz, Carl E. Walsh**, *Economics*, Publishing House: Economică, Bucharest, 2005, p.729.

government itself has adopted programs to increase spending, which exceeded revenue from taxes.

Characteristic of this period is the co-existence of a large public debt with high interest rates compared to previous periods. National debt is owed to live alone. Thus, an increase in debt it meets a high level of interest paid by govern, which constitutes a part of that expenditure increases. So, finance budget deficits increase the national debt. For these reasons, and some economists have expressed fear about the possibility that in future budgetary policy to be able to help prevent economic recession.

Due to its high share in the global economy and world trade, the role of the dollar in the unfolding international economic flows, the large U.S. deficits must be viewed through the prism and their consequences on the international community. Of great importance are the effects on interest rates, imports and exports, the pace of economic growth, and repercussions on the dollar. Note that in many countries, budget deficits coexist with trade deficits and payments that have immediate implication external.

An important relationship is that between the current national debt and current and future generations and the possibility to return the loans and to pay interest in respect thereof. In general, the public debt determines transferring funds from a group of individuals to another in the same period. But this transfer can contribute to an undesirable redistribution of income.

Access state resources saved the population is a matter of trust. While the public has confidence that his government will be able to pay interest when the debt reaches maturity, he will be willing to loan the government, he would be willing to purchase quantities of increasingly high government obligations. And, given that government obligations are considered almost risk free to the public trust must be considerable in the government's ability to pay debts.

Unlike a private firm that goes bankrupt in the case of excessive debt, located in the same situation, state creates excess aggregate demand (the situation is different when it borrows from the outside).

Debt can lead to increased taxation when the state pays the interest by the collection of taxes and duties. If the interest payment is made through loans, increase the proportions of the deficit, which stimulates aggregate demand and inflationary pressure increases. Effects are considerable especially when the Central Bank deliver money needed to pay state debts. The State may pay the domestic debt and money issues that, over a certain limit, increasing prices. Interest on national debt could result in redistribution of income from those fees and taxes borne by those who hold government bonds.

Increasing interest rates affect debt-national budget revenues, contributing to the increased deficit. This trend is reflected in the share of national debt interest payments to GDP.

To the existence of public debt is done and the release of tickets for the bank. Thus, when the state budget is in deficit, the Treasury Public issue treasury bills to cover their needs and banks subscribe to these bonds. When banks sell these bonds the Central Bank, the credit the banks, they can withdraw the amounts required.

National debt can be associated with a low rate of capital formation affecting future generations through the stock of capital goods inherited. As a result of these very different implications are numerous theoretical disputes about the benefits and costs the national debt. Many economists argue that although the national debt entails some difficulties, they are minimal in comparison to inflation and unemployment. Orientation towards balancing the budget, they argue, would contribute to worsening business variation. For these reasons, it shows that budget policy should be used to promote a balanced economy to fully use the resources and not to achieve a balanced budget, which should not constitute an action.

Due to the impact of public debt, particularly on the functioning of the global economy, financial system and therefore on monetary and financial policy is necessary to determine an optimal level of share in GDP, based on purely economic considerations.

The degree of support of growth increases the importance of debt management and its management. Thus, analyzing the structure and composition of debt should be consistent with the effective combination of measures of monetary policy and budget. Called public borrowing, public debt is a source of supplementing the public financial resources. The phenomenon of indebtedness of states and governments expanded greatly in recent decades, which illustrate the inclination of extension of the economies of their indebtedness increases based on a growing indebtedness.

The engagement of public debt

Initiative of the prior operations loans (motivation, contacting creditor's surveillance issue, etc.) is, according to the law of public finance in the Government responsibility. Approval, however, returns to Parliament, which sets annual limits on loans that can engage the government, so, their destination. This increases reliability and security policy towards its creditors, and the nation control on the financial management of government.

1. Internal debt

After the time is employed, is distinguished:

a) Internal debt in the short term (or floating) is contracted by the government or local authorities from savings, banks, public and other holders of money available.

Aim to call this form of loan is to cover the annual budget deficit, public expenditure cover of national interest or domestic debt refinancing

Methods used to cover internal debt in the short term are:

➤ ***Issuing and placement of treasury bills***

By law, the Ministry of Finance may issue during budget implementation to the Government treasury bills bearing interest and maturity by the end of the financial year to cover current cheluielilor. Their total can not exceed 8% of the total budget. Treasury bills may be purchased by banks, and economic or population. They are securities to bearer. Issuance and placement of treasury bills is a widely common in many countries, and buyers are usually banks.

➤ ***The issuance of state bonds in the short term***

which is to meet temporary financial needs special (national defense). These are investment interest paid on certain maturities. They can be bought by companies, societies, banks, individuals and redeem the time.

➤ ***Loans from banks authorized to issue currency.***

In exceptional cases, the annual budget law may establish by granting the central bank a loan without interest, to cover state budget expenditure on account of normal lending, without exceeding 10% of the total budget. Shall be refunded within 6 months of the current revenue budget or a loan from the state.[4]

➤ ***Take the cash savings or other public institutions.***

It is a loan that is based on cash that is formed into the financial-bank savings, insurance persoaneşi of things, etc.. Retrieving is made in short time (in the cadre of the budget exercises) provided the refund before the end of the financial year. Is based on a protocol signed between the Ministry of Finance and the institution which provides credit conditions including lending by the government guaranteeing the refund of amounts collected.

b) Internal debt in the long term

Long-term loans it lunches to start supplementing the financial resources to cover general needs. These loans have implications for a longer period of time. Assume the existence of premises: the presence in the economy of capital available, the market where capital can be traded securities issued. Is of utmost importance in the public trust in general and not just in government (it may change to maturity securities).

It is also necessary that the economy can support, without difficulty, the public debt. Launch long-term borrowing takes place through the issue of bonds, rents, etc. which are negotiable securities.

Issue and their placement can be done: some bankers or consortia of banks, direct government subscription or direct sales companies. Issue is different goal: to satisfy the public need general restructuring of the economy, cover exceptional needs (eg: War, military gifts, etc.). In addition to voluntary public borrowing, governments resort, in exceptional cases and forced loans (payment of salaries to civil servants bond loan). Loan repayment is made by the annuity is a process for annual payment by the debtor of the amount of money that represents the loan installments and interest attached.

2. External debt

Until now it considered in default that debt was held by residents. In this case, accumulation or stabilization of the debt resulted in redistribution of income between generations, between those which are imposed on today's duties and taxes and those on which will be imposed in future. When the debt is held by foreigners, the situation is different.

Honoring external debt involves transferring resources to the rest of the world. This will require recording a current account surplus, meaning to spend less than gaining it. In the case of internal debt, the government can always correct the effects of income distribution, through proper counterbalance taxes and transfers.

This option is no longer available for external debt as one reason for that is more painful. External public debt includes external loans in the long term, short-and medium-contracted directly by local authorities, the autonomous regime, companies, and firms with government guarantees.

Economic agents appeal to foreign loans to obtain or complete the necessary financial resources to satisfy some needs related to

[4] Law of public finance no. 500/2002

development programs, filling the reserve currency, reducing the balance of payments deficit, stabilization or economic restructuring, etc... Beneficiaries of foreign loans may be: the government, National Bank, institutions and public authorities, autonomous, banks, companies, etc... The decision to involve foreign loan belong to the government and the entire responsibility for their actions involving the completion of loan commitments, but the approval is given by the Parliament of the country.

It sets the annual level of debt and the limits the government can borrow. Creditors may be external: governments, banks state banks and private financial institutions, international organizations (IMF (International Monetary Fund), IBRD (International Bank for Reconstruction and Development), EBRD (European Bank for Reconstruction and Development).

IMF provides loans only short-term only to the governments to balance the balance of payments and monetary redress movement.

World Bank (IBRD) provides loans for long-term investment in the economic and social environment, health, etc.

Beneficiaries of these loans are government, some public and private authorities to ensure that government.

Romania received FESAL loans for economic restructuring from the EBRD and the IMF credit lines "stand by" to reduce the deficit of balance of payments.

Interest on these loans is much lower than the private banking market. Government guaranteed external loans contracted some of autonomous commercial companies, etc. [5]

[5] **Ionel Micu**, *Economics and guvernamental policy*, Publishing House: Era, Bucharest, 1999, p.89.

To recover the risks arising there from, it was constitute "the risk fund" as extra - budgetary regime.

Macroeconomic impact of the indebtedness

Maintain public debt within reasonable limits means:

- A rigorous budgetary policy, centered on the austerity;
- Maintain budget deficits to levels below 3% of GDP;
- Coordination of economic policy instruments, particularly mutual adjustment of fiscal and monetary instruments;
- Debt financing through securities issues.

Negotiable instruments issued by the state in Western countries have witnessed a great momentum, described by modernizing them.

Effects of excessive indebtedness of the state economy takes various forms, among which may be listed:

- Deterioration of the monetary and financial flows in the economy;
- Decapitalisation of economic agents;
- Increased future tax burden;
- Lowering interest rates;
- Generating inflation etc

It is obvious the need for the state debt at certain times, but this need should be aimed at freeing up productive and temporary tax burden, or the support of productive expenditure budget.

3.1. The influence of government debt on future generations

While the U.S. recorded in 2004 a surplus, the government owes 3.4 trillion $, about 12,300 $ per person, the amount gained in the previous debts. Using loans to finance debt and not increase the tax burden of lower consumption is passed on to future generations of taxpayers[6].

The U.S. Government has funded part of the expenses for the 2nd World War the contracting of loans, not by raising taxes. Assume that the bonds issued would have been bought by people 40 years.

Thirty years later, they leave work, and the government decides to redeem the bonds by increasing taxes levied on those working in the labor market. As a result, the government transferred funds from these young workers to those who worked during the war, but now have retired. Thus, part of the cost of war is borne by future generations who have entered the labor market after the war. Consumption over the life of those who have borrowed money the government will be least affected. They could choose to purchase shares or bonds issued by companies, the war (to the extent that is financed through debt or government bonds) affect the achievement of savings, but no money available to be spent over the years life.

Ricardian Equivalence

If individuals are concerned with their relatives will decide that when the government recorded a deficit, to increase savings and in this way may leave a greater legacy to their children who will be affected by higher taxes necessary government repayment of loans.

In terms of the examples show in previous generations who worked in the period of the 2nd World War would have to reduce consumption and increase savings, leaving larger bequests next generations, who could thus pay higher taxes not be influenced levels. In this optic, no matter if the government increased taxes or borrow. In each case, current generations will have a lower consumption - either because of higher taxes, either because of the desire to leave the next generation legacy. This vision is called equivalence ricardiană because existence implies equivalence between funding costs through taxes and government funding in the form of loans.

3.2. Elimination of deficit

Three factors contribute to the elimination of deficits. First, policy changes have managed to reduce costs. Secondly, vigorous economic growth has helped increase revenues from taxes. Thirdly, even after taking into account the economic growth, that income taxes have increased over the estimates.

Since 1990, were set certain ceilings on expenditure in the U.S. They were extended in 1993, and through additional programs to succeed reducing costs in the form of benefits for certain people. Other measures to reduce the deficit were included in the balanced budget law and the fiscal relaxation from 1997. Eliminating the deficit and was helped by increased revenue from taxes. Strengthening the economy explains part of this increase. Until 1999, the U.S. economy recorded the longest economic expansion in history. As the economy was expanding and revenues increased, earnings taxes have proved to be higher than estimates. Income from certain types of taxes was higher than estimates, even after taking into account the effects of economic growth. For example,

[6] **Joseph E. Stiglitz, Carl E. Walsh**, *Economics*, Publishing House: Economică, Bucharest, 2005, p.729.

revenue from taxes on capital gains was very high, probably due to the outstanding performance of the stock market.

The impact of policy changes and economic developments on the prospects of budget is reflected by the changes in high estimates on the size of the deficit.

If policies remain unchanged, for the future is projected budget surpluses, which led to focus the debate from discussions about eliminating the deficit by seeking how they can be spent these surpluses.

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