Budgetary Deficit and Public Debt

Public Economics

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Fiscal imbalance

What does it mean generally ?

Which factors influence it ?

Task: You have your own budget (R – E = FI)
- do you reach positive / negative FI ?
- why do you reach them ?
    - Planning
    - Risk (under)estimation and evaluation
    - Ability to manage expenditures
    - Ability to predict unexpected situations

Types of fiscal imbalance

Short-term FI = budget revenues differ from the budget expenditures in the certain period (budget/calendar year):

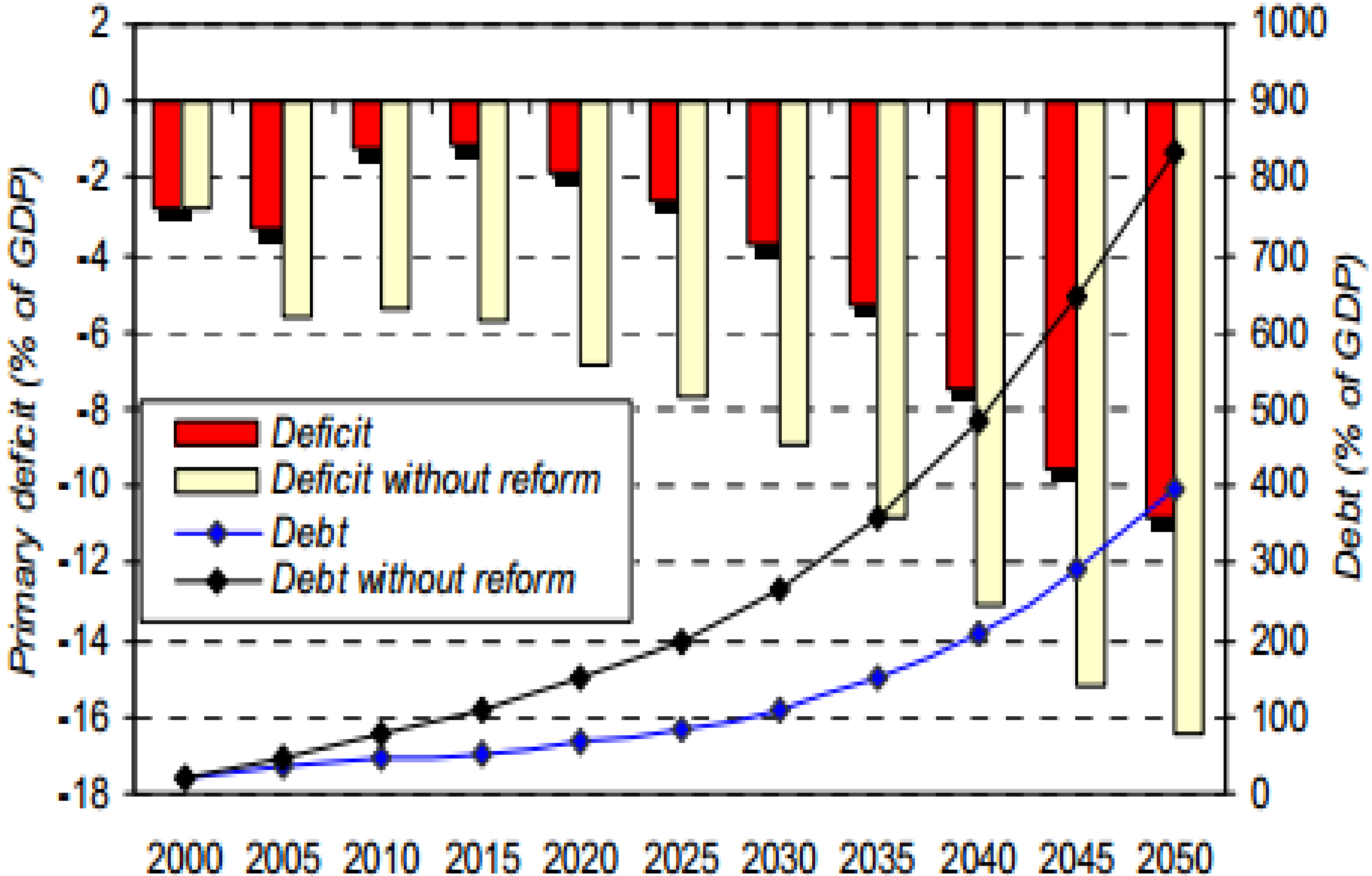
1. revenues > expenditures → surplus
2. revenues < expenditures → deficit

Long-term FI = accumulation of public deficits or surpluses and other liabilities of government → increasing or decreasing of public debt

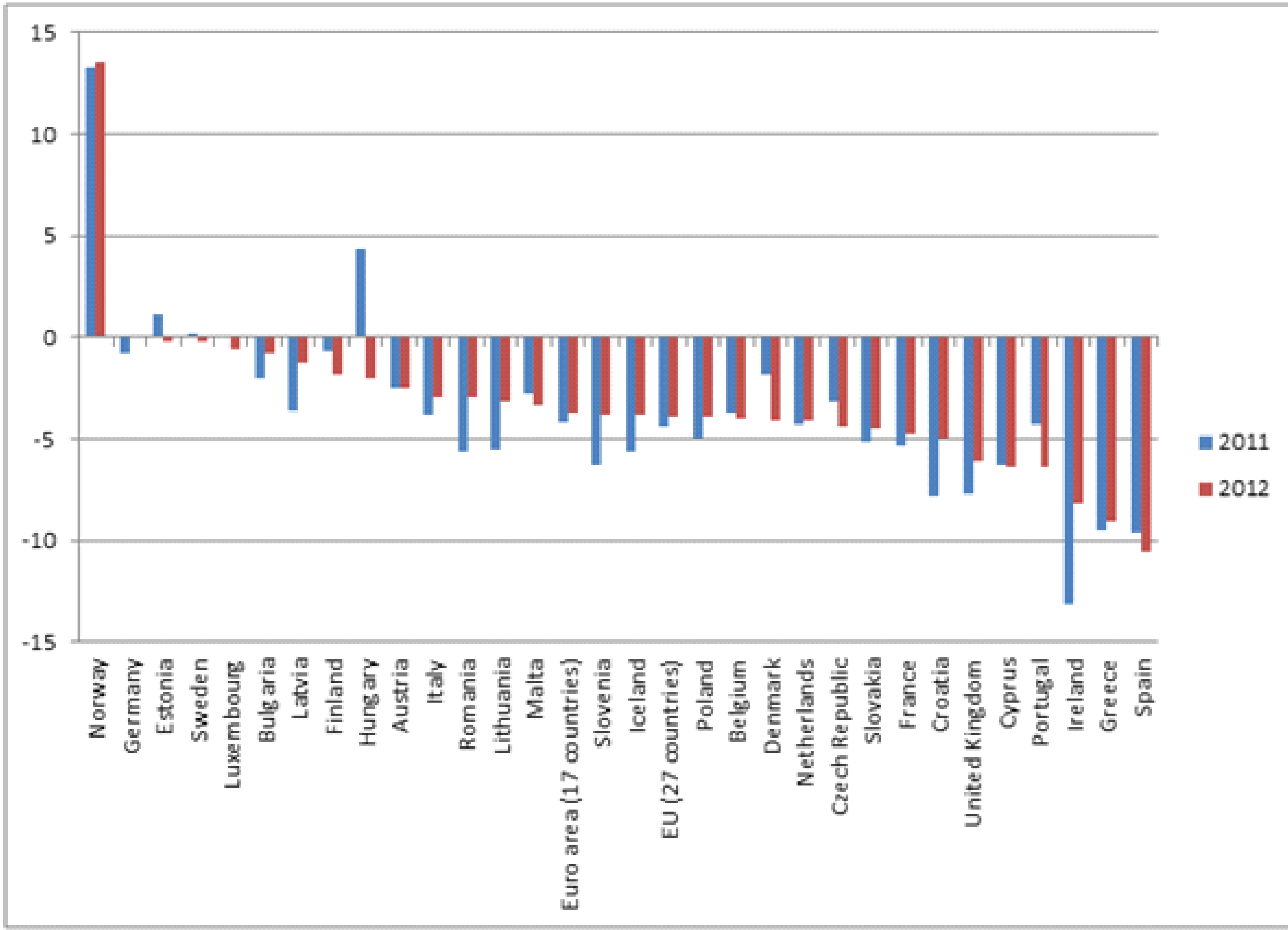
Something to think about

Are public deficits bad and surpluses good ?

Does it mean that state which has public debt is not able to manage budget in proper way?



Source: Czech Ministry of Finance, 2003.



Source: Eurostat (2012) Net borrowing or lending of consolidated general government sector [% of GDP].

Formation of fiscal imbalance

Fiscal imbalance is not result only of government actions but of other factors and thus we have to identify all possible influencing factors and divide the deficit according to relevant causes.

Try to identify some factors:

- 1.
- 2.
- 3.

Formation of fiscal imbalance

Types and components (1):

Passive (Cylical) – related to the development of economic cycle (higher level of unemployment, lower public revenues, higher public expenditure)

Active (Structural) – related to the development of long-term governemnt financial management. Associated with government actions and policies.

Total budget deficit is equal to the sum of the structural (active) deficit and the cyclical (passive) deficit.

Components of fiscal imbalance in Czech Republic

	2009	2010	2011	2012	2013	2014	2015
Fiscal imbalance	-5,8	-4,8	-3,1	-3,0	-2,9	-1,9	-0,9
Cyclical component	-1,1	-0,6	-0,3	-0,6	-0,7	-0,4	-0,1
One-off and transitional operations	0,3	0,0	-0,1	-0,3	-0,1	0,0	0,0
Structural component	-5,1	-4,3	-2,6	-2,1	-2,2	-1,4	-0,8

Source: Ministry of Finance CR (2012) Fiscal Outlook

Formation of fiscal imbalance

Types and components (2):

Primary deficit – net deficit after deducting the interest payments from the total deficit.

Public debt interests – related to the existence of debt and associated with holding of debt.

Total budget deficit is equal to the sum of the primary deficit and interests of public debt.

What affects the amount of interest costs, or the interest rate, for which the state borrows the debt ?

Who lends money to the state?

Public debt

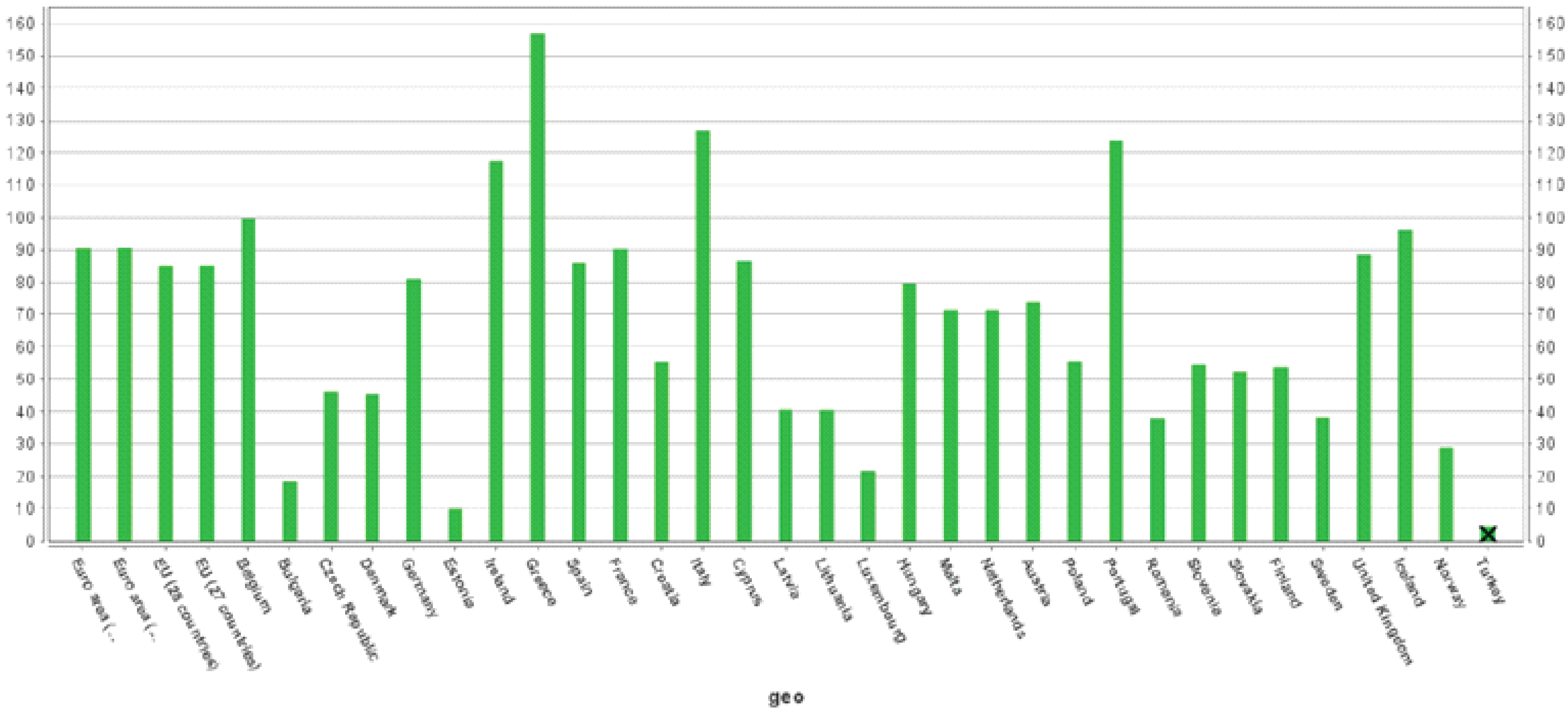
Long–term fiscal imbalance (negative).

Two views:

1. accumulation of deficits or surpluses

2. total sum of liabilities

Public debt – comparison



Source: Eurostat (2012) General government gross debt [% of GDP]

Types of debt

Internal = residents lend money to the state

+ redistribution

+/- creating debt for future generations

- displacing private investments

+ creation of low-risk assets

External = foreigners lend money to the state

- national currency impacts

- exchange rates risks

- transfer

Types of debt

In national currency

= debt is held in domestic currency

In foreign currency

= debt is held in foreign currency

Czech Republic case:

http://www.mfcr.cz/cs/verejny-sektor/hospodareni/rizeni-statniho-dluhu/dluhova-statistika/struktura-a-vyvoj-statniho-dluhu

Czech debt holders

Non-financials companies	1,42 %
Financial institutions	60,01 %
Government institutions	3,75 %
Households	4,33 %
Non-profit organizations	0,26 %
Non-residents	10,48 %
Foreign bond issues	19,75 %

Source: www.mfcr.cz

How to manage state debt ?

Passively

- favorable ratio of the rate of economic growth and interest rates ($1+r/1+y < 1$)
- not anticipated inflation
- foreign grants and aid

Actively

- budget solutions (raising taxes, cutting public spending, ...)
- sale of state assets – privatization
- extraordinary tax
- monetization of debt
- political-administrative solutions (postponement of debt repayment, non-recognition of the debt)

International aspects of state debts

- state debt is not a local issue, there are potential impacts and implications around the world (international impacts)
- bad debt management may result in state bankruptcy (example in Argentina has led to cancel 75% borrowed funds, drastic budget cuts, growing level of unemployment, barter...)
- tendencies for external control of state finances (EU fiscal rules)

Thank you for your attention :-)