PUBLIC DEBT MANAGEMENT DURING ECONOMIC CRISIS

Cosmin-Mihai LEFTER

ABSTRACT

During a crisis, public debt management is very important because the management methods of a touch-and-go economic situation on a national level are determining the financial wellbeing of a nation. During a crisis, the national wealth is decreasing, and during economic growth, it increases both macro economical and for each individual. As we are talking about a global economy, budgetary deficits are present in every state’s economy, through a contagious economic phenomenon. Thus, during economic growth, the GDP level is high and during economic decrease, the GDP is decreasing. Public debt management policies influence both the foreign exchange rate and the GDP. Foreign direct investments, that generate the increase of employment, and lead to sustainable economic growth, have suffered during the economic crisis, and public debt is much more severely experienced by the population.

KEY WORDS: public debt, economic crisis, foreign direct investments, economic system, global economy, budgetary restrictions

JEL CLASSIFICATION: E60; E65; E30; E32; E37; G01; G00; G10; F61; F62; F63.

INTRODUCTION

A country’s GDP, as an aggregate element, is proportional to the wealth of the individuals in that country. This way, the state is financing its expenses through taxes and by contracting loans both externally (from the World Bank, IMF, EU, etc.), and domestic (from the financial institutions of its banking system). The state’s budgetary restrictions show that the difference between the states’ total expenses and its fiscal revenues must find its correspondent in the national debt’s variation. When the total expenses exceed the fiscal revenues, the state has a deficit that it finances through loans. If the revenues from the state’s budget are larger than the expenses, the state registers a budgetary surplus and will reimburse some of the public debt it has contracted. See Moşteanu, et al. (2008) which have shown in “Public Debt Management”, especially pp. 125-129. One must always consider the long term consequences of the public debt in order to come up with a viable economic policy to aim for economic growth. Therefore, it is extremely important that the repercussions of maintaining a stable balance between the debt and the GDP must be established.

Public debt represents one of the foundations of the current global economy, as a science. Public debt management represents the management of the governmental policies in order to reach a public deficit as low as possible or optimally related to the economic growth rate. Therefore, if the growth rate is superior to the interest rate one may state that this had as objective the economic development of the country, and this way there is a low risk of reimbursing the public debt in the future. Public debt profitability is given by the low risk of reimbursement and the economic growth rate, both on a short and on a long term.

1 PhD student at School of Management at The Bucharest University of Economic Studies, Romania, cosminlefi@yahoo.com.
1. THE ECONOMIC FRAMEWORK IN WHICH PUBLIC DEBT IS MANAGED

A country’s public debt is the essential factor of people’s wealth. This is due to the believe that during democratic political cycles, different debts are registered from one Government Program to another, and from one period of time to another during the same government. This way, if at the beginning, a government contracts less loans for economic rehabilitation, at the end of that government, larger amounts are being borrowed so that the wellbeing sentiment is induced to the population. This way, public administration represents the largest centralization system of value demands in the governmental ensemble at national level. See Matei (2003) which have shown in "Public Economy. Economic Analisys of Public Decisions”, especially pp. 229-232. The public decisions must reflect the majority’s demands. Only in this way, an efficient government is operating, and the economy may develop.

The reality shows that few public systems have a detailed view over their activity. Few governments take the necessary decisions for a real impact of the economic policies on people’s lives. See Decleris (1992) which have shown in “Deuxieme ecole europeene de sistemique”, especially pp. 72-150. The economic policies must be based on the following elements:

- Social communication (education, research and development, or even mass media policies);
- System of values (justice, anti-crime policies);
- Social security (social policies sustained in health and social housing);
- Governmental acts (state’s organization through fiscal policies, budgetary policies or even local administrations);
- Natural environment (environmental policies, agricultural, urban and regional planning, durable growth policies);
- Public zone (environmental policies, agricultural, urban and regional planning, durable growth policies);
- Affective systems (ethnic policies, family policies).

There must always be the objective of impact assessment, the impact that the state’s economic policy may have. The objective of every efficient government is to improve its policies, by reducing the number of laws and by making them more clear to the public. Public debt is closely related to foreign direct investments, that determine whether the balance of payments registers a deficit or a surplus. For this reason, the legal path must positively adjust the capital comings, that create wealth. On a national level, the costs of borrowing, both externally and domestic, must be well established at all times. The effect that must be closely watched is the increase of the investment’s efficiency at national level. Therefore, if a country will contract a loan to cover a budgetary deficit in the pensions system, no economic growth will be created, but only an improvement of a category’s lives, which otherwise may risk not getting the money from the state. If the money is used to build highways, employment is generated, these bring on revenues for the state’s budget and also result in infrastructure work, that attract other investors. Investments may generate investments, bringing the economic growth every state needs.

When the United States economy started to decrease, in 2008, it was expected that the crisis will extend, like in the great depression of 1929-1933. Everything started on a deregulated market, with low interest rates. See Stiglitz (2010) which have shown in “Freefall”, especially pp. 41-56. This led to the creation of a speculative balloon, that started in the real estate and made its way all the way to the US labour market.

Europe was affected in its most painful spots of its economy (the economies of the states with a fragile banking system and excessive public debt), which was based on a rather fragile foundation of intercultural differences. Countries with large public debts and increased financial instability experienced serious problems. In a world where companies have tried to increase their incomes, a system crisis came that is based on the mighty greed of the finance people all over the world. It was believed that the world’s economy would continue to rapidly grow in the years 2000s, but it has
been demonstrated that the world’s economy must calibrate through economic crisis based on malfunctions of the open market and lack of global regulations. Future profits have been dropped in favour of short-term liquidity. The security of the resources should had been well established before the crisis, because unprofitable money spending, either we talk about investments in overstated houses in the case of the already indebted population or, the misusage of money in the public sector led to a situation unprecedented in world history. Shock present in the banking world will be felt for many years to come. The issue of sovereign debt crisis that hit the U.S. and EU countries will lead in time to other crises to be resolved. Addressing these errors of modern democratic system must be the last refuge of the world economy. For this cause we should prevent the emergence of new crises, because it is easier to prevent than to treat an economic disease with global effects. Programs such as TARP in the USA or the loans from the European Union to Greece are examples of solutions that are designed to help the state economy. The measures are welcome, but not enough to prevent a social crisis. Mankind is at a high risk in terms of the emergence of a new economic crisis. It is noted that, public debt management mechanism will not look like the past, like the principle of the invisible hand, and the state's role will increase in economic regulation and management of public funds to achieve financial targets imposed by the times we live.

2. THE CURRENT FRAMEWORK OF THE ECONOMIC CRISIS

Mankind has always tried, over time, to focus its spheres of influence around the various centres of economic thought. Whether we talk about The Central Powers and the Allies during World War I, or NATO, EU and NAFTA today, we can see that mankind has tried to maximize their wealth at the state level. Nowadays, the crisis began in 2008 has repercussions like a world war on global finance. The globalized world of the modern man is a hierarchical clade of power held through democracy seen as capitalism’s mobile. The transnational corporation has a paramount role in shaping the current economic model based on development, and because of that, power must be seen as a mean of reaching the profit. In another train of thoughts, corporations have as a main objective grabbing important shares of the global market. Their dominance is so great that arouses feelings they are too big to fall prey to bankruptcy. This idea developed in the subconscious of the American spirit, and because of this reason, the financial system had to be saved. Based on the theory of the end of the cycles, like the Kondratieff cycle, which is a long economic cycle, we can reveal that it is necessary to outline a new model or modify an existing economic model. Thus, globally there are three economic models: American (characterized by exclusion, because it includes economic growth and political freedom, but excludes social cohesion), European (an inclusive model, because it includes economic growth, political freedom and social cohesion) and Asian (characterized by exclusion, because it includes economic growth and social cohesion, but excludes political freedom). See Marin (2004) which have shown in “European Economy”, especially pp. 24-38. It is clear, due to the global crisis, the creation of a new capitalist order, which aims to impose stability and trust in state institutions and private economic gear. The free and self-regulatory market which is the cornerstone of global democratic system undergoes changes due to changes of the sense of the world. This way, the American model which governed the world so far suffers greatly because of the deregulatory mistakes that were implemented by the U.S. policy makers. There must be created a model that allows intervention in the economy to some extent at the country level and the engine of the economic contingent of measures should be that of fiscal and budgetary policy, which is meant to replace the monetary policy in this role. Thus, monetary policy in the current crisis has shown its limits and the leading role in the economy should be taken by the fiscal and budgetary policies. At the same time, neither the other economic models are not doing too well due to the contagion effect felt through globalization. In this way, the huge dollar reserves China possesses and Europe’s sensitivity to the weakness that the US show, led to the extension of the problem from one model to one system.
International economy is seen as a sum of national economies both in interdependence and in competition with each other. Economic systems and models emphasize in this case on the balance of advantages and disadvantages that concerns the relationship between economies at a global level.

In the context of national regulation on competing companies to achieve market control, national economies are actively competing. Thus, some economies end up winning, while other come up losing this casino game imposed by global capitalism.

Foreign direct investments depend entirely on sound management of the public debt. In times of acute economic crisis investments decline in the context of the caution shown by investors regarding the uncertain future of the economy. Economic and social tensions that have developed within the group of PIIGS countries (Portugal, Greece, Italy, Ireland, Greece, Spain) have generated instability and mistrust in the European business environment, which to relaunch must reinvent its public debt management policy. The trends, on an internal and global level, of the current developments show a crisis in the Economics, which will have to focus its comparative analysis on economic systems and models. In this way, the current trend of the global economy is to find the solution out of crisis which can lead to a disorder in the hierarchy of the global powers. For sure, when out of this crisis, the world will not look like before and the type of democracy that was in the past will not be the same in the future.

3. THE ANALYSIS OF THE METHODOLOGY USED FOR MANAGING PUBLIC DEBT PORTFOLIO

The effects of public finance policy in Romania aim at improving financial and budgetary discipline by keeping the deficit under close observation. Thus, public debt management which aims to refinance the budgetary deficit and to refinance the public debt through medium and long term limitation of the costs and the risks associated must be integrated with efficient management of cash available in the State Treasury General Account which aims which aims to provide short-term financial resources necessary to carry out public expenditures also avoiding gaps between revenue and public expenditure. See Ministry of Economy and Finance (2010) which have shown in “Public Debt Management Strategy”, especially pp. 34-47. Depending on the government debt portfolio in order to reflect the effective management of the government debt portfolio to the change of certain significant factors during the analysed period, covered by the strategy, stand out the following elements:

1.) The influence of lower economic growth on governmental public debt as a share of GDP
2.) Cumulative impact of lower growth and higher budgetary deficits (3% of GDP – maximum accepted by the Maastricht criteria)
3.) The influence of domestic currency depreciation against the euro and dollar on the interest payments on governmental debt;
4.) The influence of the increase or decrease in interest rates on interest payments on governmental debt.

Public debt management is a process closely linked and dependent to the fiscal, budgetary and monetary policy. In this context, the government debt portfolio analysis should be performed taking into account both the domestic macroeconomic developments and forecasts (growth, inflation, budget revenues and budget deficit, monetary conditions and structural reforms) and internal capital market efficiency and the global economic developments because it needs to be taken into account the international influences on Romania’s borrowing conditions on the foreign financial markets.

4. RESULTS OF GLOBAL ECONOMIC POLICY

Currently has created a new paradigm of deregulated financial markets. Our world is imperfect in its own way because it is what we are trying to understand. Globality is currently in the worst economic situation after the crisis of 1930. The current crisis is the end of credit expansion in the
USA and the end public debt made for unsustainable economic development over time. Thus, we created a new paradigm that marks the end of an epoch of deregulated economy and the onset of an era of economic and financial regulation. See Soros (2008) which have shown in "New Paradigm of financial markets", especially pp. 7-37.

The crisis started in 2008 is unlike any other so far. Neither the U.S.A. recession that took place in 1990-1991, which was characterized by a high unemployment it is not the magnitude of the current. This is due both to the management plan in place to reduce unemployment by Clinton leadership and geo-strategic circumstances of the fall of the communist regime in Eastern Europe. By creating markets for global products, Eastern Europe has become an attraction for both the U.S.A. and the other highly developed countries of Western Europe. Actual result, recorded after 23 years since the fall of communism, is that some states have excessively indebted both for economic development, which has not proved sustainable over time and to finance budget deficits that were widened around 2008-2012. Eloquent example of Greek debt is one that need not be repeated over time. The state budget must be balanced one, and public spending should create national wealth and not by a shortage of money mismanagement. See Krugman (2010) which have shown in "The conscience of a Liberal", especially pp.174-280.

Economic and financial market includes credit flows, investments and remittances. See Bari (2010) which have shown in "Treaty of global political economy", especially pp. 236-336. The new economy of flexible in the market, competitives and innovatives firms needs a favorable economic environment in which to grow. A economic policy system, which does not budget absurdly debtor in a country, should be the fundamental element of a growth strategy both short term and long term.

5. CONCLUSIONS

Identifying and analysing the effects of the budgetary deficits and public debt on the national economy require particular attention by state institutions, to prevent economic slippages. The financial liquidity that states must have is extremely important in managing a balanced state budget. Public debt management must be done carefully in order to achieve sustainable economic growth. The problems that Romania is currently facing in terms of public debt management are rooted in the political regime change in 1989, and the contagion of the crisis that hit the world. The consistent efforts made by our country during the communist regime to pay the external debt made it so at the beginning of 1990s, the public debt was virtually non-existent. Therefore, the increase of the public debt coincides with the changes in the political regime. The country’s need for additional financial resources has two causes: 1) the annual consolidated budgetary deficit; 2) the reimbursement of the due state loans.

By introducing into the public debt the economy’s losses, the state allows the private sector to contract loans and accumulate debt. This way, everything is performed against the entire population, that bears the public debt and that is not always in the benefit of the investments made by the private sector, which represents an unfair management of public funds. See Ugarteche (1997) which have shown in “El falso dilemma”, especially pp. 145-147. Not all budgetary allocations are made in a positive manner. This is characteristic to third world countries. The problem that mankind faces today is that even in the developed countries there is an allocation nonconsistent with the economic needs of the states. The European Union is a model of economic organization that must change its economic policy in the fiscal and budgetary areas in order to shift from financial - economic heterogeneousssity to homogeneity of the countries it consist of.

Payment difficulties appear together with a decrease in the capacity or in the will to sustain the public debt. Usually, payment capacity is associated with country risk economic factors, and the will to pay is associated to the political factors. The payment capacity directly linked to the balance of external payments. Thus, if there are enough resources coming from exports, such as: official aids, private transfers or new loans, which can finance imports and sustain the governmental external debt, than there will no longer be a country risk. The signals of possible payment
difficulties in terms of the components of the payment balance are: expert decrease, excessive imports increase, excessive payments for the external debt, the decrease or even the stagnation of capital incomings, capital outgoings, high level of due debt. See Băcescu et al. (2003) which have shown in “Macroeconomic Country Risks”, especially pp. 26-34.

The American dream dealt with serious problems during global crisis. These emerged from the great dream of greed and for this reason the crisis must first be fought where it all began. Homo economicus is an archetype of the modern man based on yield and profit reasons. The American individual and not only is struggling for wealth, which he perceives as a temporary solution to power. The economics, as a science, has manipulated human condition, creating an environment for money love. In this way, one may observe that economics is in a crisis of the system governing it. See Stiglitz (2010) which have shown in “Freefall”, especially pp. 460-487.

The management of the public debt must aim at increasing the country’s profitability by generating enough liquidities to the state’s budget in order to lead to a sustainable economic growth. Economic growth must be a healthy one, at national level, because, in the case it is based on over debt, as is the case in Greece, the repercussions may transform an air bubble into a toxic particle, that may deteriorate the economic environment already weakened. Thus, mankind must evolve from a deregulated financial system to a law regulated one, in order to build an economic model sustainable in terms of global economic growth.

REFERENCES


