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THE PROBLEM OF PUBLIC DEBT (THE CASE OF SPAIN)

ABSTRACT

The present paper concerns a crucial problem of contemporary public finances, that is the public debt. Apart from the definition, the causes and methods of incurring debt , the present paper demonstrates the acceptable limits of being indebted. Furthermore, the paper presents the scale of public debt in the world and the current status of public finances of Spain (one of the most indebted countries).

Key words: public debt, the limits of debt, public finances, Spain

1. THE CONCEPT OF PUBLIC DEBT

In the professional literature, there are multiple definitions of public debt to be found (*public* or *government* or *national debt*), also known as government or national debt. According to the most succinct student-book definitions, public debt refers to financial liabilities of public authorities related to the loans taken (Owsiak, 2005, p. 330). Other sources claim that public debt encompasses all the liabilities incurred by the Treasury, national earmarked funds having legal personality and by municipalities (Misiąg, 1996, p. 16).

The definition of public debt *sensu largo* is to be found in the supplementary documents to the Treatise of Maastricht. According to the afore-mentioned definition, public debt means "the totality of liabilities of the Treasury to national and foreign entities related to loans taken in financial institutions and directly from the governments of member countries of Paris Club or these which were guaranteed or insured by the governments or their agendas as well as treasury securities remaining to be purchased issued onto the foreign and national market and other registered liabilities of the Treasury" (Chmielewski, 1997, p. 16).

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2. THE CLASSIFICATION OF PUBLIC DEBT

The economical literature at large, particularly that on public finances, distinguishes a series of kinds of public debt. However, using the term "classifications" kinds) does not appear entirely justifiable. Perhaps from the point of view of methodology, at least equally proper is the use at that point the term "debt structures".

Assuming the criterion of the place of origin of creditors, one can distinguish the national and foreign debt[2]. The former, also referred to as internal debt, encompasses the debt in relations to local entities, resulting mainly from treasury bonds still due to be redeemed. On the other hand, foreign debt (external debt) emerges from the loans taken from international organizations, governments, banks and from the treasury bonds sold abroad.

„Productive debt" and „dead-weight debt" are the successive kinds of public debt. The criterion used in that dichotomy is the reason for its emergence. "Productive debt" is correlated with the assets (the property of the Treasury, that is land, capital and infrastructural devices of different kinds; however, "dead-weight debt" does not show the above-mentioned correlation (Dalton, 1948, p. 215–216).

Furthermore, professional literature also distinguish the following kinds of debt

1. gross and net (gross net-receivables),
2. short-term debt also referred to as liquid debt (up to one year) and long-term debt also referred to as funded debt (more than one year),
3. nominal and real (taking inflation into consideration),
4. central (national) and local (local-governmental),
5. voluntary and compulsory debt (Owsiak, 2005, s. 331–335).

In economic reports as well as in the modern opinion journalism, one can find the information about the official and real amount of public debt. The former essentially overlaps with the nominal debt. The real debt additionally comprises the so-called hidden debt, that is-among others – due payments related to health service and pension scheme. The reason for the existence of the difference between the official and real debt is the accounting system, which subdivides further into cashing accounting system and accrual accounting system. If any events causes the transfer of money, then they are referred to as *cashing*, and when the events give rise to economic consequences, they are called a*ccrual* (Dobrowolski, 2009, p. 1–5). It is worth mentioning that in the light of the definition highlighted in the point 1.1., debt regarded as real is not actually public debt because it does satisfy the is certainly a serious fiscal problem of many economies.

3. THE REASONS FOR CONTRACTING DEBT

In developed and moderately developed countries with respect to their economies, public debt is a common phenomenon and it has been in effect for dozens of years. Despite the fact that the economic situation of these countries is different, it can be said that public debt has become the constant ingredient of their public finances. The accumulation of public debt was

[2] One cannot confuse external debt of the Treasury with the overall debt, which additionally comprises the liabilities of extra-governmental sector and the sector outside banks (mostly enterprises) as well as bank sector.

the reason for much criticism pronounced not only by economists but also by politicians. For these reasons it is worth acquainting oneself with the fundamental causes of indebtedness of particular countries.

The professional literature generally distinguishes the causes of the emergence of public debt:

1. long-standing budget deficit[3];
2. the period of increased public spendings (particularly periods of wars and deep economic crises);
3. the implemented economic doctrine which can consciously assume the long-standing budget deficit and public debt as tools of state interventionism;
4. the implementation of political goals of the ruling elite which does not decide on increasing the taxes and neither does it cut spendings (the theoretical justification of such a policy is public debt-neutrality thesis for both the economy and the society as such. If one assumes that thesis is correct, then it is more advantageous for the government to take new loans than to impose new taxes).
5. Public authorities falling for the so-called debt trap (losing the ability of the due repayment of debt) (Owsiak, 2005, p. 337).

A particularly important reason for the emergence of public debt seems to be budget deficit, being mentioned at the beginning. The elementary relation between debt and the state of budget is reflected in the following formula:

$$d = d_0 + r * b$$

where:

d – the balance of government budget – conventionally conceived – in relations to national gross product
d_0 – primary deficit or budget surplus (without the expenses for debt service) in relation to national gross product
r – average interest rate in the public debt service
b – the level of public debt in relations to national gross product (Gotz-Kozierkiewicz, 1994, p. 57).

The analysis of primary balance in the government budget (Wernik, 2001, p. 10) is becoming the issue of utmost importance, which analysis sheds some light on its balancing. Primary balance provides an answer to the question how the equilibrium in the government budget would be shaped if there were no public debt and thus there would not be any necessity for its service.

It also serves as basis for determining if the amount of debt does not threaten the budget solvency.

The emergence of negative primary balance means exceeding safety threshold with respect to debt. On the other hand, the increasing primary surplus under the condition of total deficit means approaching balancing budget, which takes place at the moment of the equilibrium between the primary surplus and the expenses for debt service.

It is to be emphasized that relatively high public debt does not directly threaten the solvency of the government budget if there is primary surplus in the budget (Ciak & Górniewicz, 2002, p. 97–98).

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[3] The growing national budget spendings can obviously be covered by the method of growing tax burdens (increasing interest rates and introducing new taxes) but such a budget policy may result in the growth of inflation and impeding the pace of economic growth, which in practice may lead to the decrease of budget revenues. (A. Laffer curve).

4. THE FORMS OF CONTRACTING PUBLIC DEBT

It follows from the definition of public debt presented in the first point of the chapter that public debt is the result of contracted liabilities by public authorities. The liabilities can assume the following forms:

1. securities,
2. loans and credits,
3. receivables not regulated by public entities as well as liabilities related to legal decisions, provided warranties and guarantees and other titles (Gołębiowski, 2004, p. 710–711).

Among major securities used to finance budget deficit by contracting public debt, there are promissory notes and treasury bonds to be mentioned.

Treasury bills are short-term securities issued by the government in order to cover the current payments due. Promissory notes are usually issued in big nominals and are devoted to transactions on the so-called wholesale market. They belong to the basic instruments of open market operations; and thus, apart from satisfying the government demand on money, they are an instrument enabling monetary authorities to regulate the supply of money in the economy. Treasury bills are sold at the nominal value minus a discount according to the rules being in effect when it comes to the discount of bills.

The term of maturity of treasury bills does not exceed one year (usually it reaches three or six months). From the economic point of view, being short-term has some conventional meaning. As a matter of fact then, the process of issuing, selling and then the payment of bills last permanently. Being short-term concerns only a given series of bills then. That is why one can safely say that treasury bills as a whole are a fixed instrument of financing public debt. The essential property of bills is the possibility of adjusting their amount to the needs of budget deficit and the service of public debt (Owsiak, 2005, p. 344–345).

An important instrument used to cover borrowing requirements are treasury bonds. A bond is a security containing the issuer's commitments to pay the owner of the bond its nominal value together with the interests specified in the bonds or on the basis of general rules of subscription. The distinctive feature of the bond is that they guarantee the flat interest rate. There are many kinds of bonds. Assuming the criterion of time, one can distinguish the bonds of the following types: short-term bonds (up to 5 years), medium-term bonds (from 5 up to 15 years) and long-term bonds (more than 15 years). Assuming the criterion of the issuer of the bond, one can distinguish treasury bonds and municipal bonds.

Loans are credits are essential methods of contracting public debt. Two terms are to be explicitly distinguished. "Each credit is a loan, but not each loan is a credit"[4]. Both loans and credits may come from national creditors (mainly from commercial banks) and foreign creditors (other countries' governments, foreign commercial banks and international organizations such as International Monetary Fund).

[4] The category of credit is inextricably intertwined with the Central Bank and commercial banks having the right of money creation. A commercial bank can extend a credit at the amount considerably exceeding the financial resources possessed. If, for instance, households purchase Treasury bonds, they thus extend a loan to a country – not a credit. A similar situation occurs in the loans between countries (governments) especially in relation to the autonomy – in relation to government – of Central Bank and the Treasury resigning from direct issuing of money for governmental needs. Thus, loan is a broader concept than credit.

The professional literature distinguishes short-term credits or loans (up to 1 year), medium-term ones (from 1 up to 5 years) and long-term ones (more than 5 years) or just short-term ones (up to 1 year) and long-term ones (more than 1 year).

Modern credits are a highly diversified and wide group of financial transactions. They differ from one another mainly with respect to – as stated above – the term as well as the purpose, form of security for a debt, negotiating procedure or documentation. As a result, international credit market is not a coherent economic organism. Only loan policy ensures some coherence of big transnational banks, which manage the credit portfolio in a more or less centralized manner (Pietrzak & Szymański, 1991, p. 141).

5. THE ACCEPTABLE LIMITS OF DEBT

The appearing critical opinion concerning the accumulation of public debt and the problems with its payment give rise to the issues related to the limits of debt. The most widely accepted criterion is the claim that debt should not violate economic equilibrium. However, it seems that it is such a vague and general statement that apart from the general idea it is difficult to relate the statement to any specific amount of public debt (Górniewicz, 2012, p. 36).

Already in 1923, two indices specifying the degree of debt were produced. These were: the relation of debt to the society income and the relations of current debt (short-term ones) to long-standing debt (long-term ones) (Krzyżanowski, 1923, p. 346–347).

In the analysis of the measurements and the structure of debt, it seems indispensable relate the amount of debt to basic economic units and to international trade in particular. The whole issue concerns the indicators of debt service (the relation of debt to export (Zabielski, 1994, p. 328–329) and to national gross product) and to the average debt per capita.

In the professional literature one can find the thesis that if the increase of national gross product at a given period is bigger than the debt payment due for the same time, it can be described as situation not detrimental to a given economy.

$$\Delta GNP > OZ, \text{ gdy: } OZ = A + \%Z$$

where:
ΔGNP – the increase of national gross product
OZ – debt service
A – debt depreciation for a given period
%Z – interests from the debt

On the other hand, in case the increase of national gross product allows only for covering the expenses resulting from debt service, that is

$$\Delta GNP = OZ$$

that is the beginning of insolvency (Bernaś, 2006, p. 327). Real insolvency emerges when debt service is bigger than the increase of national gross product:

$$\Delta GNP < OZ$$

In the nineties, Organization for Economic Cooperation and Development, after the analysis of the amount of debt in many countries, assumed the following indicators:
– the relations of debt to export (the critical value is 275%),
– the relation of interests to export (the critical value is 20%),
– the relations of debt service (payment of installments and interests to export (30%),
– the relation of debt to national gross product (50%) (Kołodko, 1992, p. 70, 71).

Within Maastricht summit, which resulted in signing the Treatise of establishing European Union 7 February 1992, one specified the basis conditions of joining Economic and Monetary Union also called convergence criteria. In one of these criterion (Budnikowski, 2001, p. 369), it was assumed that base value for public debt in relations to national gross product in market prices amounts to 60% (the data presenting the relation of public debt to national gross product are demonstrated in the second chapter of the present paper).

The Treatise was nonetheless taking into account the exceptions from nominal convergence criteria. European Commission may consider a criterion to be satisfied despite the possibility that a given country may achieve a higher value than the base value, if the relation of public debt to national gross product is decreasing at a sufficient rate and approaches base value at the satisfying pace.

To a small extent, also the procedure valid in case of the emergence of excessive budget deficit relates to the amount of public debt. If the debt exceeds 60% of national gross product, then irrespective of whether it is accompanied by the budget deficit exceeding 3% of national gross product, European Commission prepares the report after the opinion on it is expressed, it becomes the basis to evaluate the issue of the emergence of excessive deficit.

The mere fact of exceeding the debt limit amounting to 60% of national gross product is not the basis to sanction a particular country (Górniewicz, 2012, p. 39).

6. SCALE OF PUBLIC DEBT

It is USA which is an infamous leader as far as the biggest public debt in concerned. Its debt exceeded 17 trillion USD in 2012, which amounted to 1/3 of the debt of the whole world (see table 1). The second biggest debtor was at that time Japan (almost 10 trillion of USD debt). The next places in this descending order were occupied by (respectively) China, Germany, Italy, France and Great Britain.

Tab. 1. Public debt of countries

Country	Public debt (billion USD)	% of GDP	Per capita (USD)	% of world public debt
World	56,308	64	7,936	100
United States	17,607	73,6	36,653	31,27
Japan	9,872	214,3	77,577	17,53
China	3,894	31,7	2,885	6,91
Germany	2,592	81,7	31,945	4,6
Italy	2,334	126,1	37,956	4,14

Country	Public debt (billion USD)	% of GDP	Per capita (USD)	% of world public debt
France	2,105	89,9	31,915	3,74
United Kingdom	2,064	88,7	32,553	3,67
Brazil	1,324	54,9	6,588	2,35
Spain	1,228	85,3	25,931	2,18
Canada	1,206	84,1	34,902	2,14
India	995	51,9	830	1,75
Mexico	629	35,4	5,416	1,11
Korea, South	535	33,7	10,919	0,95
Turkey	489	40,4	6,060	0,87
Netherlands	488	68,7	29,060	0,87
Egypt	479	85	5,610	0,85
Greece	436	161,3	40,486	0,77
Poland	434	53,8	11,298	0,77
Belgium	396	99,6	37,948	0,7
Singapore	370	111,4	67,843	0,66
Taiwan	323	36	13,860	0,57
Argentina	323	41,6	7,571	0,57
Indonesia	311	24,8	1,240	0,55
Russia	308	12,2	2,159	0,55
Portugal	297	119,7	27,531	0,53
Thailand	292	43,3	4,330	0,52
Pakistan	283	50,4	1,462	0,5

Source: CIA World Factbook 2013 (https://www.cia.gov/library/publications/the-world-factbook/).

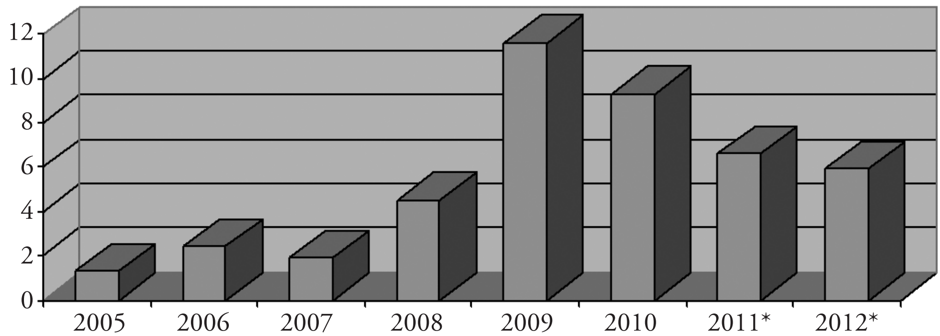
The main indicator demonstrating the public debt burden of a given country was its relation to the national gross product (GNP). Among the biggest debtors the worse result was "achieved" by Japan, whose public debt exceeded 214% of GNP. Very bad results fell on the countries belonging to the PIIGS group (that is Portugal, Ireland, Italy, Greece and Spain) as well as Singapore. Another vital indicator is the amount of debt per capita. In this respect, the worst predicament was that of Japan (77,5 000 UDS per capita) and Singapore (67,8 000 USD per capita).

7. THE FINANCIAL CONDITION OF SPAIN

Until recently, Spain has been regarded as a dynamically developing country. It owed its favourable conjuncture mainly to the then boom on the real estate market, which had a positive influence not only on developers but on civil engineering companies and the banks financing those investments (Sadecki, 2010, p. 57–58). The crash occurred already in October, 2008. The mortgage sales decreased then by 44%. Additionally, high unemployment rate (particularly in the civil engineering branch) limited the tax incomes and simultaneously increased the governmental spendings on allowances, which amounted to the serious budget problem. According to the predictions by Eurostat, Spanish civil engineering market is bound to shrink till 2012. The government of Jose Luis Rodriguez Zapatero implemented radical budget cuts amounting to about 15billion Euros, that is 1,1% GNP. Such actions added to the credibility of Spain in the eyes of financial investors. On the other hand, direct investors – to a considerable extent – fled Spain – as well as the other member countries of PIIGS group. Direct foreign investment outflow additionally strengthened the descending trend and solidified the economic recession to boot (Gruszecki, 2010, s. 113–116).

Like the remaining member countries of PIIGS group, in the recent years, Spain has been burdened with the permanent budget deficit (see picture 1). It took the greatest proportions in 2009 and 2010 (respectively 11,6 and 9,3%). According to the prognosis by European Commission, in the forthcoming years, the deficit of public finances is bound to decrease, but its proportions (oscilating around 6% of GNP) are to be considered as highly unfavourable.

Pic 1. Budget deficits of Spain within 2005–2012 (in % GNP)



* prognosis

Source: my own lay-out based on the date provided by European Commission

Another problem of Spanish economy was the indebtedness of private sector (households and companies). The mortgages valid for 50 years and the possibility of tax relief amounting to 15% of paid installments contributed to the situation in which the net sum of debt in the whole economy amounted to more than 340% NGP in 2010. Among the developed countries, only Japan and Great Britain were then more harassed with debts (Wróbel, 2010, p. 153).

The decrease of Spanish trustworthiness enforced the increase in the treasury yield.70% of issued bonds in 2009 had a maturity date shorter than a year. Those short-term obligations were to be renewed in the successive year but on the less favourable conditions. In 2011, the pay-off will coincide with the necessity of the rollovers of long-term bonds, which can deepen the economic crisis in the country. According to experts, Spain may not be able to take that burden (Górniewicz, 2012, p. 133).

In the first months of 2011, the government of Span disclaimed the possibility of accepting some aid from European Union and instead focused on reducing its own spendings.

At the beginning of February, Spain signed a contract with the trade unions and employers enabling to raise the pensioners' age from 65 to 67 years old. The government also started to fix the regional banks (the so-called cajas), the balance of which were to be cleared of any bad debts (Walewska, 2011, s. B6).

Despite these action, in the middle of 2011, the fear concerning the condition of public finances in Spain were still bigger. In order to alleviate the fear, in August, the Prime Minister Jose Luisa Zapatero announced that he should constitutionalize the limit of public debt and budget deficit. However, specific information was not given (Potocki, 2011, p. A8).

The condition of Spain deteriorated in September. Then it transpired that the government would have to spend 5 billion Euros to take over three regional banks (NovaCaixaGalica, Calixa Catalunya and Unnim), which – due to the crisis on the real estate market – did not find private buyers and whose bankruptcy might cause social panic. According to "Financial Times", the government would need as much as 50 billion Euros to capitalize all the cajas, and not merely 15 billion Euros, as was announced until recently.

Such big spendings make the Zapaterian plan of the budget deficit reduction and the achievement of public finances stability much harder. What is more, the situation will be worsened by the low economic growth.

According to the prognosis by European Commission in 2011, NGP of Spain will increase only by 0,8%. To save the public finances, the government implemented in Septempber the additional tax from the wealth for 160 000 people, whose wealth exceeds 700.000 Euros. They will pay from 0,2 to 2,5% of the value of their wealth, which should contribute 1,08 billion Euros to the budget (Bielecki, 2011, p. A8).

In November 2011, there were general elections in Spain, as a result of which the leftist Prime Minister J. Zapatero lost power. The decisive victory of centre-right People's Party did not calm the investors down.

The return on sales of 10-year bonds increased the day after the elections by 6,6%. Investors feared if the new government will be implementing public finances reforms. During the electional campaign, the future Prime Minister Mariano Rajoy announced that he was not going to raise taxed and neither lower the revenues in the budget sector. Instead he promised to search for savings through lowering the spendings. The governmental agencies were to be penalized for excessive cost and national companies which would be losing market competition with private ones were to undergo privatization. M Rajoy announced the decision of the regulated blockade for self-governmental spendings. The new PM will be trying to stimulate economy by dint of tax reliefs for companies employing new workers (Kozieł, 2011, A9).
Up to 100 billion Euros, that will be the aid from Euro Zone countries for the banks of Spain – as was agreed on by the Ministers of Finances of Euro – group countries. The eventual amount of the aid will be determined after conducting the audits of bank balances being in the greatest financial need. The money for Spanish banks will come from European Financial Fund – this temporary one (EFSF) and a "stability" one (ESM), which will be viable in July. It is meant as support for Spanish banks and not the whole Spain – as is stressed by the Spanish Minister of Finances Luis de Guindos. Spain will be the fourth country of the Euro Zone, which will receive the international financial support (http://www.bbc.com/news/business-18382659). Until now, the greatest amount was cashed in by Greece (240 billion Euros). Furthermore, the Greek scale of being indebted to the creditors was also reduced. Portugal got 85 billion Euros of financial aid and 78 billion Euros was attributed to Ireland.

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