An Evaluation Of The Relationship Between Budget Deficits And External Debt: The Case Of Turkey And Spain

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Abstract

Budget deficit is an important economic problem subject that is emerging in today's world, especially in many developed and developing national economies. Within this scope, as domestic resources are inadequate in the developing or underdeveloped national economies, these countries have to use several financing means in order to maintain economic growth and development. One of the most important one of these means is external debts. In this regard, external borrowing is an indispensable financial resource for today's countries. In addition, financial integration movements accelerates many countries around the world who seek borrowing more easily. Hence, this leads to the creation of higher debt stock. At this point, the purpose of this study is to evaluate the relationship between budget deficits and external borrowing. In addition, it also aims to analyze the current data of Turkey and Spain economies.

Keywords: Budget Deficits, External Debts, Debt Stock, Turkey, Spain

Introduction

External debt is quite an important financial resource for many national economies around the world. In this context, external debts have been taken recently in order to reduce saving and external exchange gaps, close the budget deficits, and maintain the economic growth and development. When external debts taken due to inadequate domestic resources are used effectively, they will increase savings, investments, and employment opportunities. Also, they may speed up the economic growth and development process as well. However, the ineffective and the unproductive use of external debts results to several problems in the economy. As a result, external borrowing will become a current issue again in order to repay these debts.

In a national economy, budget deficits have been indispensable because of inadequate public revenues and increasing expenses. Thus, this is the result of increasing the duties and functions of the public sector. In today's world, an important reason for budget deficits is the informal economy which has been increasing day by day and the governments which remain incapable in preventing such situation. Most especially in underdeveloped and developing countries, efforts of the governments to accelerate economic development and to industrialize the economy have been an important effect on debt increment. In this context, the continuous increase in debt has started to bring along the higher budget deficits.

However, if public revenues and entities of debtor nations are not enough to repay the external debts, countries in question may encounter debt crises. As for a discontinuing external debt stock, it might be a serious obstacle for the development and growth of a country. For this reason, countries should implement effective and productive debt management policies. Therefore, in political decision making period, it is essential to effectively and productively use external debts which have been transferred to the economy through external borrowing.

Budget deficits and borrowing relation

The concept of budget deficit is one of the most encountered situations in the developed and developing countries. This concept generally states that public expenses are more than public revenues. It has been tried in financing the budget deficits emerging in many countries around the world in recent years by means of seeking several methods. Of course, borrowing is the most used method of them. Increasing budget deficits in a national economy brings along the higher borrowing and it hinders the maintaining of the financial maintainability of the economy.

Financial maintainability is defined as the rate of public sector borrowing requirement to GDP in a national economy, rate of noninterest surplus to GDP in that country, and the rate of public debt stock to GDP which are stable or constant. In other words, the abovementioned three criteria which takes place together, in that each of those three is stable or constant, is the basic condition for financial maintainability (Croce & Ramon, 2003:5).

Therefore, lack of financial maintainability in a national economy and cyclical fluctuations in the economy are basic determinant factors in the formation of budget deficits. In addition, the most important items that increase the budget deficits are social safety and health expenses. In these countries, incurring expenses without considering the social and political balances increases the budget deficits. The increase in public expenses increase significantly as the tools and materials for defense are under development continuously, and when its costs are quite high (Akdoğan, 2009:81). In addition, differences in economic development between the countries, administrative structuring, and social and political differences have an influence on budget deficits as well. Therefore, the state allocates much more resource to these fields due to structural problems (Akalın, 1993:210).

Within this scope, the borrowing reasons/factors of developing and underdeveloped countries are as follows (İnce, 2001:14):

- Capital stock is not at a significant level across the country.
- Big financing opportunities are required for industrialization and development.
- Industrial structure has been founded as external – dependent.
- Scientific and technologic innovations are monopolized by developed countries.
- Continuous public deficits and budgetary equilibrium cannot be maintained.
- Expenses of defense are at high levels.
- Natural resources and raw material are not enough.
- Chronic deficits of balance of payments are continuous.
- Refunding in order to pay the liabilities due.
- External exchange reserves are not at a significant level.

Today, in many countries, public revenues remain quite incapable to meet public expenses. Due to such reasons, the state applies for different financing resources which can be alternative to public ordinary revenues. In this regard, the state can apply for these methods in financing the budget deficits: domestic borrowing, external borrowing, monetization, using the external exchange reserves of central bank, privatization incomes, and short-term speculative capital flows (Fischer & Easterly, 1990:127).

Subsequently, it has been determined which and how the abovementioned public financing resources will be used according to the current economic policies in that country. In this context, if a wrong policy application is chosen, solidary negative effects and inescapable macroeconomic imbalances will be inevitable. As a result of this, public financing will become much more important.

Within this scope, the reason a country needs to borrow is described by financial reasons, economic reasons, and other reasons. Firstly, in considering the financial reasons, these include budget deficits, deficits in the balance of payments, and financing for big project or investments. Secondly, considering the economic reasons, they include the achievement of full employment in the economy and influencing the decisions of economic departments of the country in a positive manner. Finally, considering the other reasons, they are described as: financing for expenses of defense conducted across the country, financing for extraordinary expenses, and refunding in order to repay the debts of the previous periods (Saatçi, 2007:95).

Effects of budget deficits on external debts

Borrowing that is quite important in terms of all the countries around the world, in order to maintain the economic growth and development, is described as an obligation which takes place depending on fund borrowing or the purchase of goods and services on credit. External debts have an important place among the external financing resources. In general, external debts are defined as loans borrowed by domestic established persons and institutions from the external persons and institutions in different ways (Evgin, 1996:15).

External debts can also be defined as transfer flows which are obtained generally from external resources. They have an increasing effect on national income during the period of borrowing, and a decreasing effect during the repayment period that appears as a result of international affairs (İnce, 1996:86). In the studies conducted by the World Bank and OECD, they stated that (WB&OECD, 1988:19): *"Gross external debt is the sum of obligations arising from the agreement and requirement to repay the capital with or without interest, or the interest with or without capital for the debts which should be repaid by residents in a country to non-residents in this country, which they have borrowed and haven't repaid yet."*

External debts are financing resources which are mostly applied by developing countries than the developed countries. They are used in facilitating economic growth and development purposes in these countries. Particularly in the developing national economies, principal external borrowing reasons include lack of national resources, public deficits at high levels, lack of domestic savings, and deficits in the balance of payments etc.

The basic reason why the external borrowing has become an obligation in terms of public sector is the difficulties experienced when the public expenses are financed by ordinary resources. In this regard, while external debts that have been used generally in development and growth of national economies were a source of income estimated to use only in extraordinary periods in the past, they have become an ordinary source of income today.

Subsequently, while external debts usually provide an additional resource to economy in a national economy, it results in an extra resource outflow from the country when interest and capital payments are made. In other words, in the repayment period of the debt, debtor countries have to decrease their investments, consumption, or both of them in proportion to debt servicing.

In a national economy, public deficits bring along certain important macroeconomic problems. However, the basic reason for this depends on how public deficits are financed. In this context, while closing public deficits through coining causes inflation in an economy. Also, closing them through domestic borrowing results to increase in the interest rates, credit crunch, and the exclusion of investments and consumption.

In this direction, it is possible to close the public deficits by different financing types according to the economic status. However, it is possible to mention a powerful relation between budget deficits and external borrowing in the economies whose national capital markets and domestic borrowing opportunities are limited. In this context, as a result of closing the public deficits through external borrowing in a national economy, it is stated that current account deficits will increase in this economy. Thus, in certain cases, crises might take place in balance of payments and external debt stocks (Easterly & Hebbel, 1993: 213).

Furthermore, as high budget deficits took place in a country in an easy way, it has an increasing effect on external debts. The increase in external debt stocks may cause negative effects on the general level of prices, employment, posterity, income distribution, and economic growth. External debts are an important resource for developing countries in terms of economic growth, financing of the investments, and importation. In recent years, however, negative effects have emerged as the rates of external debt which have reached high levels in these countries. Unsustainable levels of public debts causes negative results of external exchange crises, devaluation and credit erosion of the country, etc. (Pradhan, 2009: 2-3).

Within this scope, external debt maintainability problem gained importance across the world during the 1980's. As a result, those years are defined as *"years of external debt crises"* depending on external debt crises which many industrialized countries experienced in general (Yılancı & Özcan, 2008:91). Due to different reasons, countries are not able to repay the debts. In general, countries are not able to pay the debts because of three basic reasons in the literature. These reasons are: *Liquidity deficiency, Debt bankruptcy, and Being unwilling to pay the debts* (Önel, 2003: 2).

In most developed and developing countries, weak capital markets and limited opportunities of domestic borrowing result in meeting the budget deficits through external borrowing. As for the financing of budget deficits through external borrowing, it causes increment in external debt stock. In addition, increments in the external debt stock will result in the reformation of budget deficits. As seen herein, external debts emerge as both the reason and the result of the budget deficits (Arıcan, 2005: 93).

Budget deficits in turkey and spain - external debt issue

In general, external debts in a national economy make contribution to close the external commerce deficits and to remove the imbalances in the balances of payments. In this regard, external debts are effective in ensuring economic stability. These factors, however, may vary by conditions of external debt. Also, these conditions include the interest rate of the external debt, term structure, project and technology dependence, and so on (Eker & Meriç, 2000:248). In this context, while external debts create positive effect in a country during the period of borrowing, it causes negative effects during the period of repayment.

In many countries around the world, some basic problems of the economy include inadequate domestic savings and capital stock, high increments in the public expenses, external trade deficits requiring consistency, and requirement of external exchange at every period. These problems have increased the external debt usage of the countries. As a result, it has caused an increase in the total stock of external debt. High rates of external borrowing occur during the period of crisis. However, the countries in question leave the counties in a difficult situation during the period of repayment. This is because the external exchange resources were inadequate. As a result of such reasons, external debts reached an unsustainable point.

Along with globalization movements that are speeding up in today's world, countries have reached an outward-oriented structure. In this regard, an economic problem experienced by any country across the world would begin to affect any other country closely. In recent periods, borrowing crises experienced particularly in European Union countries have caused an increase in the studies conducted on these countries. Therefore, the purpose of this study is to evaluate the relation between budget deficits and external debt in terms of Turkey and Spain economies. Within this scope, we will analyze the total budget deficits and the total external borrowing of the national economies in question by means of the following tables.

Table 1. Basic Macroeconomic Indications in Turkey and Spain

	Economic Growth (%GDP)	Current Account Balance (%GDP)	Export / Import (%GDP)	Investment (Annual variation in %)	Exports (Annual variation in %)	Imports (Annual variation in %)
Spain						
2010	-2,5	-4,2	77,8	-4,9	9,4	6,9
2011	-0,6	-3,8	81,8	-6,3	7,4	-0,8
2012	-2,1	-3,6	88,2	-8,1	1,2	-6,3
2013	-1,2	-4,0	93,5	-3,8	4,3	-0,5
2014	1,4	-4,6	95,6	3,4	4,2	7,6
Turkey						
2010	9,2	-6,2	61,4	30,5	10,3	31,8

2011	8,8	-9,7	56,0	18,0	17,7	31,2
2012	2,1	-6,2	64,5	-2,7	13,7	-1,7
2013	4,2	-7,9	60,3	4,4	-0,1	6,5
2014	2,9	-5,7	65,1	-1,3	4,4	-3,6

Source: World Bank; Economic Indicators & IMF: World Economic Outlook Database

Table 1 above illustrates the annual several macroeconomic data of the Turkey and Spain economies. Within this scope, if we consider this data in terms of either country first, economic growth in Spain economy was -1,2 in 2013 and 1,4 in 2014. Thus, this rate was 4,2 and 2,9 for Turkey's economy. Then, if we consider the current account balance, while this rate in Spain was -4 in 2013 and 4,6 in 2014, this rate was 7,9 and 5,7 in Turkey. From the table, if we consider the rate of exports meeting imports, while this rate in Spain was around 95% in 2014, it was around 65% in Turkey. In addition to this, for the countries in question, it is possible to see annual exchange values of export, import, and investments in percent through the above table. Also, it can be seen as illustrated on graphics, various comparative rates of Turkey and Spain economies, in the Appendix.

Table 2. Budget Deficits and External Debt Indications in Turkey and Spain

	Budget Balance (%GDP)	External Debt (%GDP)
Spain		
2010	-9,4	61,5
2011	-9,4	69,3
2012	-10,3	86,1
2013	-6,8	92,6
2014	-5,8	97,6
Turkey		
2010	-3,6	40,1
2011	-1,4	39,4
2012	-2,1	43,1
2013	-1,2	47,3
2014	-1,3	50,3

Source: World Bank; Economic Indicators & IMF; World Economic Outlook Database

In Turkey and Spain economies, budget deficits occurs because there is an ineffective tax system and public revenues which are incapable to meet the public expenses. In these national economies especially, budget deficits reached too high levels as a result of the experience of the global crisis in 2009. As for governments in these countries, they preferred to use domestic and external borrowing rather than an effective tax policy system to finance the budget deficits which were increasing very rapidly within a short time. Eventually, in parallel to the external debt stocks that are increasing rapidly, external debt services have also increased. Also, important pressures on the budget have become a current issue.

In economics literature, there are several studies demonstrating that debt crises takes place generally in countries whose external debt term structure is short. Thus, weak macroeconomic structure in these countries requires short-term borrowing. Furthermore, reaching the global capital markets has become easier through financial integration movements. As such, it has resulted in borrowing at high levels and in transferring these debts to the unproductive public expenses. As for short-term external debts at high levels, they render the countries weaker against the external shocks.

Conclusion

In recent years, of course a political stability is required to control the high budget deficits and decrease the external debt stocks in many countries across the world. As for increasing the tax rates which is the most common method to close the budget deficits, it will not be a permanent and effective solution. However, policymakers generally cut down the public expenses and try to close the budget deficits to some extent. As an effective way, it requires imposing legal and constitutional restrictions to public deficits and public debts in order to ensure that budget deficits and external debts are not above a certain level.

In an economy, when debt interests cannot be paid by budget incomes and are paid through refunding, it indicates that the country is at a debt bottleneck. In other words, it is possible to indicate that debt bottleneck is the continuous debt that is increasing in itself. In general, debt interests are met by budget incomes. However, when the interest load reaches high levels, it will be inevitable to apply the refunding in order to make interest payments. Such a situation results in a continuous increase in debt stock and then debt bottlenecks or debt crises.

However, in order to remove debt bottlenecks, budget incomes requires reduction to a level at which budget incomes can be covered. To be able to realize this, it is required to increase the revenues or decrease the expenses. In addition, provided there is a surplus in the budget, debt stock should be reduced in the long term. On the other hand, pressure of interests on the budget should be decreased. Today, certain regulation is required to be made in order to decrease the public deficits particularly in the developing countries. These regulations can entail the fact that it is required to increase the tax incomes so that public incomes have parallels with public expenses. In order to increase the tax incomes, it is required and important at this point to decrease tax rates, expand the tax base, and prevent the informal economy.

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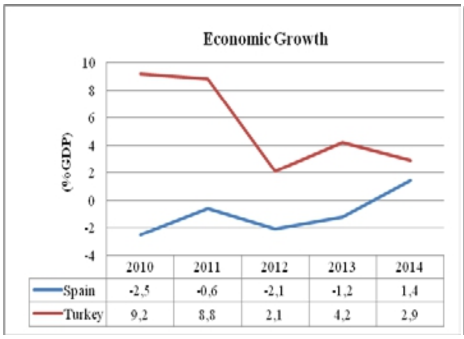
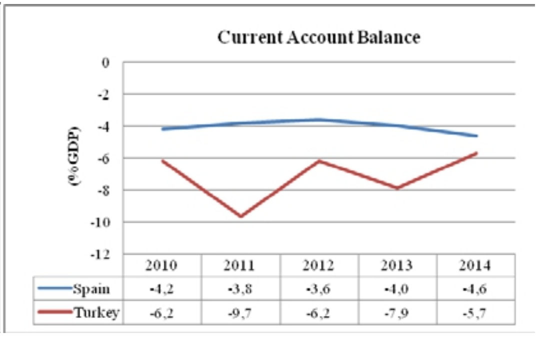
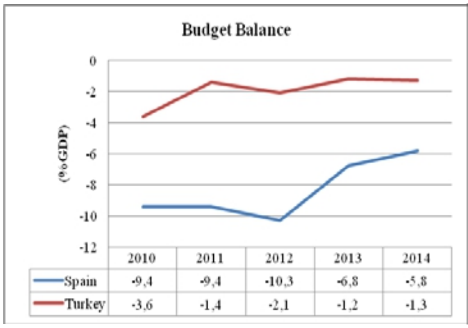
Appendix



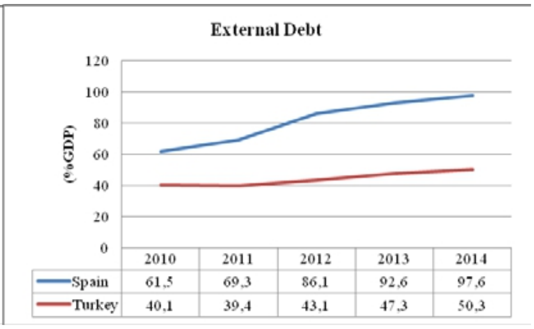
	2010	2011	2012	2013	2014
Spain	-2,5	-0,6	-2,1	-1,2	1,4
Turkey	9,2	8,8	2,1	4,2	2,9



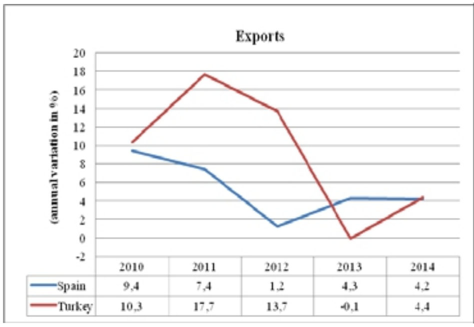
	2010	2011	2012	2013	2014
Spain	-4,2	-3,8	-3,6	-4,0	-4,6
Turkey	-6,2	-9,7	-6,2	-7,9	-5,7



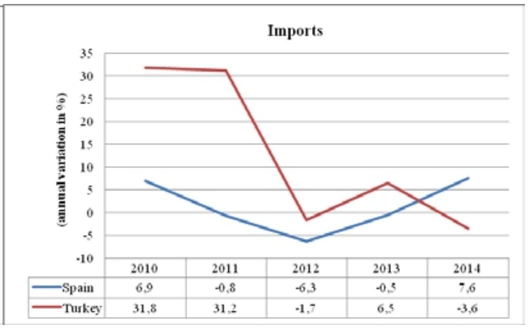
	2010	2011	2012	2013	2014
Spain	-9,4	-9,4	-10,3	-6,8	-5,8
Turkey	-3,6	-1,4	-2,1	-1,2	-1,3



	2010	2011	2012	2013	2014
Spain	61,5	69,3	86,1	92,6	97,6
Turkey	40,1	39,4	43,1	47,3	50,3



	2010	2011	2012	2013	2014
Spain	9,4	7,4	1,2	4,3	4,2
Turkey	10,3	17,7	13,7	-0,1	4,4



	2010	2011	2012	2013	2014
Spain	6,9	-0,8	-6,3	-0,5	7,6
Turkey	31,8	31,2	-1,7	6,5	-3,6