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Debt and Deficits

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A famous quote of Mark Twain is: “The only certainties in life are death and taxes.”

If the American humorist were back again in the 21st century, he would add one more to the list: “Debt”.

Debt dominates life of the individual, whether young adult (credit card purchases); households (housing loans); or business firms (loans for operating and capital needs).

Nations have become adventurous with overspending, “legitimate” or “illegitimate” and “responsible” or “irresponsible”.

Legitimate expenditures are on essentials: law and order and justice and protection of private property. The “illegitimate” expenditures are commerce and trading, which are best left to the private sector. Responsible ones are provision of public infrastructure and clean air and potable water, and irresponsible are those such as military misadventures.

The latest instance is Greece’s behaviour.

Using the Euro club card, Greece heavily borrowed overseas. It breached the membership criterion: debt should not exceed 60 percent of GDP. Kirkegaard of Peterson Institute for International Economics indicted thus: “Greece is fundamentally a corrupt dysfunctional government that is unable to raise enough tax revenues to pay for its expenses.”

The debt of Greece is 165 percent of GDP.

Debt in advanced countries

Japan’s debt is the highest: 205 percent. Next come, Italy(120); US (102); France and UK (86); Germany (81); Spain (68); and Netherlands (65).

Japan's debt history coincides with that of recession of the 1990s, which continued into the 2000s. Japan's past budget deficits included a 2 trillion yen corporate bailout to assist weaker private sector companies. This practice is unacceptable in America. Republicans condemned President Obama's bailout for auto industry which turned out to be successful.

Remember the bumper sticker of US Vice President Biden: *Osama Bin Laden is Dead, the General Motors is Still Alive!*

America's public debt is US$11.4 trillion (72 percent of GDP). With the holdings of intra-governmental bodies of US$4.9 trillion, the total public debt is $16.3 trillion (102 percent of GDP). This is less than what it was when the World War II ended in 1945: 113 percent which decreased in the next 30 years.

The string of annual fiscal deficits commenced from 2001 when the war against terror began. Financing the Afghan and Iraqi wars is a continuous burden. In the latest fiscal year ending September 2012, the deficit is US$1.1trillion (7% of GDP).

By ending the wars and with no new international policing role, the US debt is controllable. President Obama avoided active role in the Libyan liberation and relied on economic sanctions in the Iran crisis. With the fresh mandate, he will pursue his agenda of reducing annual deficit through rise in taxes on the rich and by effecting cuts in expenditures.

The strength of America in terms of productive resources and technological superiority makes the country a safe haven. Its debt is held by others, including China which accumulated trade surpluses. The US dollar is the world reserve currency. The euro has yet to become a competitor.

Rest of the world cannot expect that its debt will be held by others. If countries cannot service debts through their annual tax revenues, they become broke. Insolvency of a nation leads to devaluation of its currency with its attendant miseries.

The choice before Greece is limited. Quitting the euro and getting back to its old currency involves high adjustment costs of devaluation. So continue in the euro zone and survive with austerity measures.

Fiji's Debt

Public sector debt comprises two components, domestic and external debt. Fiji's debt level has fallen, from 56 percent (domestic: 47 percent and external: 9 percent) in 2010 to 52 percent (40 percent and external 12 percent) in 2011. External debt went up following the 2011 overseas bond. If we include contingent liabilities (debt of statutory agencies guaranteed by government) of about 15 percent, Fiji's debt is 67 percent of GDP.

Fiji's debt level is lower than the Indian Ocean countries (Mauritius, Seychelles and Maldives: 70 percent) and the Caribbean countries (80 percent).

The concern is: how to contain it?

The answer is fiscal sustainability. That hinges on: can Fiji smoothly finance its 2013 and future budget deficits without generating large increases in debt?

Fiscal sustainability is determined by capacity to produce primary surplus: revenues minus expenditures. From primary surplus, interest payments are met. Producing primary surplus depends on controlling rise in operating expenses.

The 2012 budget gave huge tax reliefs. Corporate tax rate was reduced to 20 percent, with a substantial cut in personal tax rate as well. There may not be any further scope in tax relief, as the threshold level was also raised.

Focus will have to be on cuts in operating expenditures. Budget deficit, which was 3.5 percent of GDP in 2011, has to decrease further if debt level has to come down to the targeted 50 percent level in 2013.

Fiji's 2013 Budget has to follow a lower fiscal deficit path.

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