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## POLICY OF DEFICIT FINANCING IN UKRAINE AND ABROAD

*The article explores the problems of determining the limits of deficit financing of economy. The conditions of deficit financing in Ukraine and abroad are studied. The interrelation between the dynamics of deficit financing and economic growth is revealed. The expediency of deficit financing of Ukrainian economy is proved.*

*Keywords:* deficit financing; budget; budget deficit; national debt.

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## ПОЛІТИКА ДЕФІЦИТНОГО ФІНАНСУВАННЯ В УКРАЇНІ ТА ЗА КОРДОНОМ

*У статті розглянуто проблеми визначення меж дефіцитного фінансування економіки. Вивчено стан дефіцитного фінансування в Україні та за кордоном. Виявлено взаємозв'язок між динамікою дефіцитного фінансування та економічним зростанням. Обґрунтовано доцільність дефіцитного фінансування економіки України.*

*Ключові слова:* дефіцитне фінансування; бюджет; дефіцит бюджету; державний борг.

*Табл. 1. Рис. 6. Літ. 17.*

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## ПОЛИТИКА ДЕФИЦИТНОГО ФИНАНСИРОВАНИЯ В УКРАИНЕ И ЗА РУБЕЖОМ

*В статье рассмотрены проблемы определения границ дефицитного финансирования экономики. Исследовано состояние дефицитного финансирования в Украине и за рубежом. Выявлена взаимосвязь между динамикой дефицитного финансирования и экономическим ростом. Обоснована целесообразность дефицитного финансирования экономики Украины.*

*Ключевые слова:* дефицитное финансирование; бюджет; дефицит бюджета; государственный долг.

### Problem statement

For the past ten years, the problem of deficit financing has become relevant for many countries. The reasons for that are as follows: change of development rate of the global economic environment, intensity of cyclical fluctuations, reduction of technological structures etc. Use of deficit financing is closely connected with the problem of determining its limits, which influences both economy's financing parameters and debt security of a country.

### Latest research analysis

The relevance of the researched problem is proved by the works of such Ukrainian scientists as: T. Bohdan (2013), V. Demyanyshyna (2008), V. Zaichykova (2011), F. Yaroshenko (2011). They study the issues of optimizing budget deficit in Ukraine. Among foreign scientists we can mention here G. Favara and P. Valta (2012), J. Crucus and C. Trebesch (2013). They investigate the default risks and consequences of reducing deficit financing in Europe.

The complexity of the deficit financing problem is that there are no universal recommendations for all countries. Security parameters on volume and dynamics of deficit financing are individual for each country and in order to prove such parameters for Ukraine, it is necessary to study the foreign experience of financing.

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**Research objective** is to identify the interrelations between tendencies of deficit financing and economic growth abroad and to justify the expediency of deficit financing in Ukraine.

### Key research findings

Budget deficit is a problem studied in various aspects by experts from many countries. Today, in Western science and practice there are 3 major approaches to this problem: "healthy finance", "deficit financing", "functional finance" (Lindholm, 1983). Among them, the relevance of deficit financing has increased substantially over the past 10 years. The problem of deficit financing is not a new one for national science as evidenced by the works in this field of scientists of the last century, including M. Mitilino (1929), N. Lyubimov (1956), A. Skachko (1959), V. Lavrov (1961). In the XXIst century Ukrainian scientists T. Bohdan (2013), V. Demyanyshyna (2008), V. Zaichykova (2011), F. Yaroshenko (2011) focus on both the problems of budget deficit reduction and on the potential of its use as an instrument for economy renewal. Deficit financing is transforming into an instrument for economy renewal and for stimulating its development when budget deficit becomes more active. It should be noted that active budget deficit in its pure form is rare because there is always a need for passive use of funds. However, for each country the limits of deficit financing, the volume of passive budget deficit have their own criteria which depend on the type of economy (small or large, innovative or traditional) and on the level of economic development. The current situation in Ukraine is shown in Table 1.

**Table 1. Indicators of the consolidated budget of Ukraine, 2007–2012**

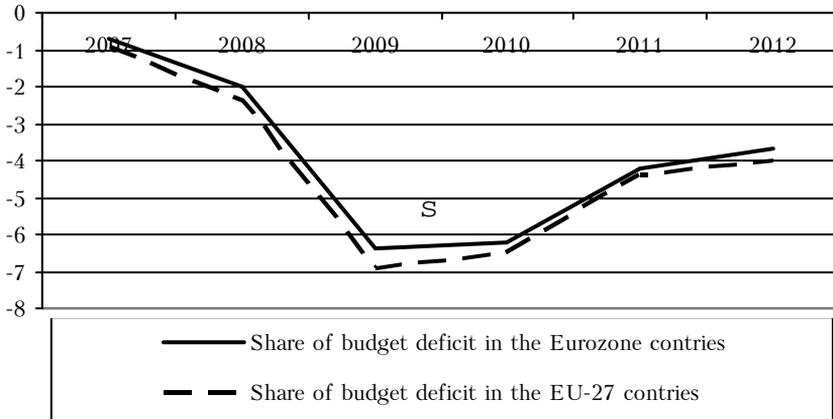
Indicators	2007	2008	2009	2010	2011	2012
Total financing	7701.70	14124.54	37258.13	64864.94	23057.89	50785.69
Financing by debt operations	5550.14	23446.39	91041.41	97567.33	36273.26	44745.39
Borrowing	12149.63	33558.04	122436.22	124459.06	83783.25	115435.61
Domestic borrowing	3738.06	27360.06	64256.54	70214.76	54141.23	72458.81
Foreign borrowing	8411.57	6197.98	58179.67	54244.3	29642.03	42976.8
Repayment	6599.48	7111.64	31394.81	26891.73	-47509.99	-70690.22
Domestic obligations	2495.77	4016.52	18014.99	19822.03	-32369.59	-38417.65
Foreign obligations	4103.71	3095.11	13379.82	7069.69	-15140.4	-32272.57
Revenue from privatization of state property	2458.81	482.29	807.85	1093.39	11480.31	6763.54
Funding by active operations	-307.25	-12804.15	-54591.14	-33975.78	-24695.68	-723.25

Source: Made by the author according to the reports on budget performance issued by the State Treasury (treasury.gov.ua).

As Table 1 shows, the need to finance budget grew sharply in 2009–2010 due to the crisis, but at the same time it is a disturbing indicator as to the problems of debt security support. During this period, there was a negative trend when the actual indicators of budget financing exceeded the planned ones. The situation improved in 2011 when the actual need for deficit financing turned out to be lower than the planned one. In 2012 however, the negative tendency renewed. It should be noted that the need for foreign borrowing in Ukraine is caused by both the official budget deficit and the negative trade balance. The long-term excess of imports over exports results in foreign exchange deficit in the economy, which can be covered either by gold and foreign currency reserves of the National Bank of Ukraine or by foreign borrowings.

Deficit financing and budget security are closely related, since the need for budget financing is based on deficit dynamics. The most common indicator used to evaluate the condition of deficit security is the share of budget deficit (surplus) in GDP. The value of this indicator should not exceed 3%, which is one of the criteria for assessing budget security of the European Union countries under the Maastricht Treaty, 1992. Budget deficit in Ukraine during the researched period is mostly within the limits recommended by the Maastricht Treaty, except for 2010 and 2012. The growth of the share of budget deficit in GDP in 2010 was caused not only by the increasing gap between budget revenues and expenditures, but also by slower growth of GDP as compared to the government forecast. The growth of the researched parameter in 2012 is caused by an increase of the need for the costs assigned for repayment of previous period debts and their service. In total, the volume of deficit financing in Ukraine is defined according to both real needs of the economy and the policy of cooperation with international financial institutions.

The budget deficit dynamics in Europe has also been unfavorable for the past 5 years. Since 2007, budget deficit has been growing and reached its peak in 2009. Since 2010, the budget deficit has been reducing. At first glance, it may seem the situation with budget deficit is better than in the Eurozone, but the analysis of the shares of budget deficit in GDP of the given countries shows negative dynamics (Figure 1).



Source: Made by the author according to [http://epp.eurostat.ec.europa.eu/portal/page/portal/government\\_finance\\_statistics/introduction](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/introduction).

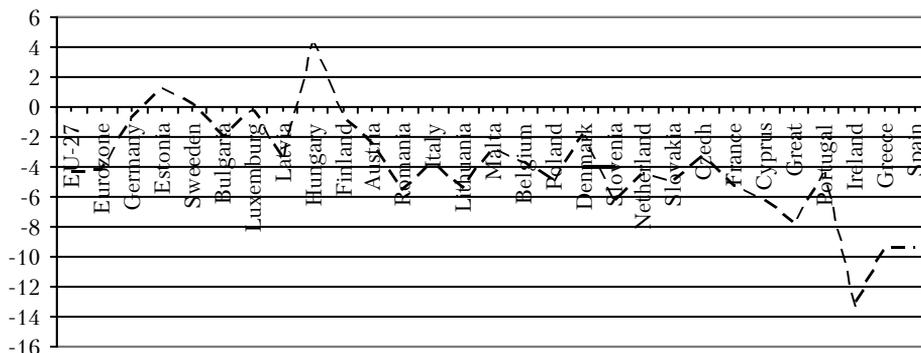
**Figure 1. Dynamics of the shares of budget deficit in GDP in the Eurozone and EU-27, 2007–2012 (%)**

The curves on Figure 1 show that the shares of budget deficit in GDP in the Eurozone countries and in the EU-27 countries are almost the same. Since 2009, the researched indicator has been higher than the value recommended by Maastricht Treaty. Though in 2010 there was a tendency of reducing the share of budget deficit in GDP, the recommended amount was not reached in 2012.

Such situation was not the same for all EU countries (Figure 2).

The curve on Figure 2 shows that within the 3% budget deficit in GDP are Germany, Estonia, Sweden, Bulgaria, Finland, Luxembourg, Latvia, Hungary and Austria. The tendency to reduce budget deficit and reach the desired value was regis-

tered in 2012 in Romania and Italy. Budget deficit in Lithuania, Malta, Belgium, Poland is within 3–4% (and tends to decrease). The researched parameter is increasing in Denmark: from 1.8 to 4.0%, in the Czech Republic: from 3.3 to 4.4%, Portugal: from 4.4 to 6.4%, Greece: from 9.5 to 10%, Spain: from 9.6 to 10.6%. The recommended value has still not been exceeded by the shares of budget deficit in GDP in the Netherlands, Slovakia, France, Cyprus, Great Britain and Ireland. Therefore, the governments in most of these countries are taking measures to reduce budget deficit.



Source: Made by the author according to [http://epp.eurostat.ec.europa.eu/portal/page/portal/government\\_finance\\_statistics/introductionof](http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/introductionof).

Figure 2. Shares of budget deficit in GDP: European countries in 2011–2012 (%)

For instance, the UK government focused its efforts on stimulating the development of the real sector and further reduction of expenditures (the program on expenditures reduction is developed till 2017). In Spain, the government is taking stronger measures which include a temporary increase of taxes on income, capital, expensive real estate, limiting growth of expenditures on social events and reduction of tax expenditures (including tax credit with interest paid for mortgage).

In Italy, the property tax for real estate at the main place of residence has been introduced again. In terms of reducing budget expenditures, the government's efforts are aimed at reducing expenditures on pension provision, which is achieved through stricter criteria for early retirement, reduced pension indexation, accelerating the increase rate of retirement age (Favara et al., 2012). Due to such measures, Italy managed to reduce its share of deficit in GDP from 3.8% in 2011 to 3.0% in 2012.

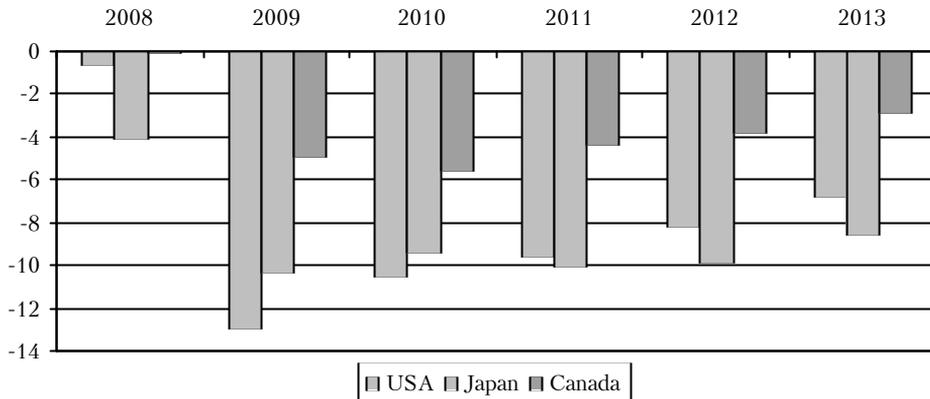
In France, the government's measures are aimed at reducing budget expenditures by stopping stimulation of investment in real estate markets, by increasing the retirement age and reducing the growth rate of expenditures on healthcare (in 2017). In Portugal, stabilization measures are aimed at increasing tax burden (increasing VAT, reducing tax expenditures) and reduction of budget expenditures, including social ones.

The absence of inexpensive additional financing makes some Eurozone countries take new measures to achieve target values of deficit instead of automatic stabilizers. As a result, deficit financing in these countries is limited by the requirements of mutual agreements aimed at maintaining stability in the European Union. The development model of European economy in terms of financing budget expenditures becomes similar to the US model. However, in the US model, a moderate level of tax

burden remains. As it was noted above, in the economies of Western Europe the following two opposing trends are combined: increase of tax burden and reduction of budget expenditures, including expenditures on social programs.

The analysis of world trends in deficit financing shows that the share of budget deficit in GDP is increasing faster in the countries with developed economy, including the United States. The fastest decrease of the share of budget deficit in GDP is in the countries with developing economy due to their greater economic potential and faster recovery from crisis. In low-income countries the recovery is slower; therefore, the share of budget deficit in GDP is reducing slower.

Higher figures of the share of budget deficit in GDP in the countries with developed economy are not for the Eurozone countries but rather for the US and Japan which actively use deficit financing for economy recovery (Figure 3).

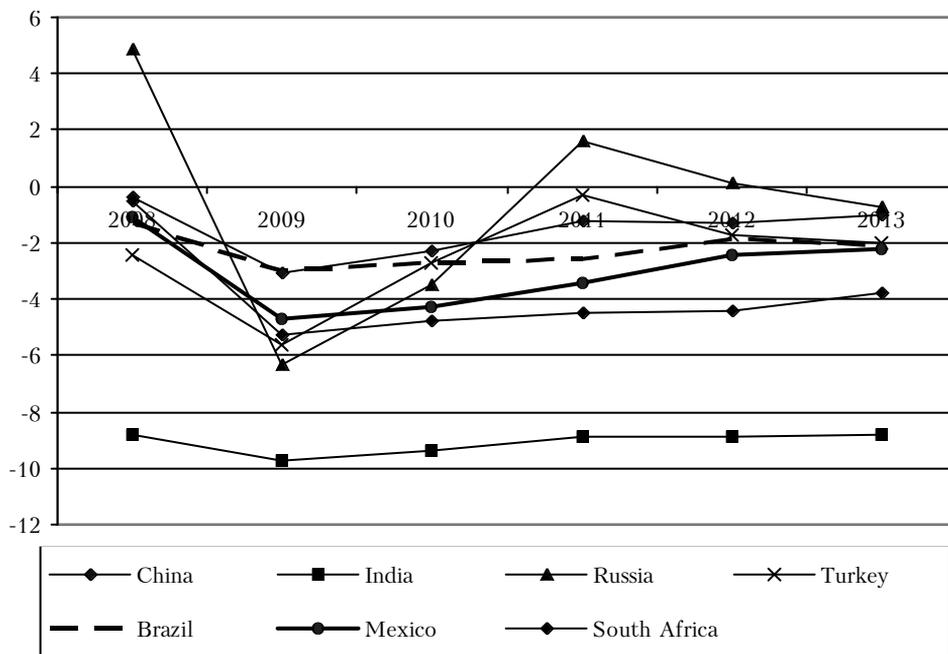


Source: Made by the author according to <http://www.imf.org/external/russian/pubs/ft/fm/2012/update/02/0712r.pdf>.

**Figure 3. Share of budget deficit in GDPs of the USA, Japan and Canada, 2008–2013 (%)**

The deficit reduction in the USA is slow due to continuation of tax privileges for the wage fund, as well as payments of unemployment benefits to those who lost their jobs long ago upon the expiration of the payment term. If these measures had not been taken, the share of budget deficit in GDP would have reduced faster. However, the government prefers to keep social stability and therefore uses deficit financing actively, which, in its turn, reduces the debt security of the USA. The growing share of budget deficit in GDP in Japan is caused by budget funding of rehabilitation programs and overcoming the disaster consequences. The total costs for rehabilitation are about 4% of GDP. The initial stage of financing is provided by the bonds which will be repaid in the future by the country's shares. In addition, the government increased temporarily the rates of corporate income tax by 3% and the rates of personal income tax. Besides, Japan is working on large-scale reforms of its taxation system, which will increase taxation of consumption. As of today, Japan may be considered the only country which finances its budget through internal reserves (domestic loans and increase of the tax burden).

Figure 4 shows the dynamics of the share of budget deficit in GDP in the countries with rapidly developing economies.



Source: Made by the author according to <http://www.imf.org/external/russian/pubs/ft/fm/2012/update/02/0712r.pdf>.

Figure 4. Share of budget deficit in the countries with rapidly developing economies, 2008–2013 (%)

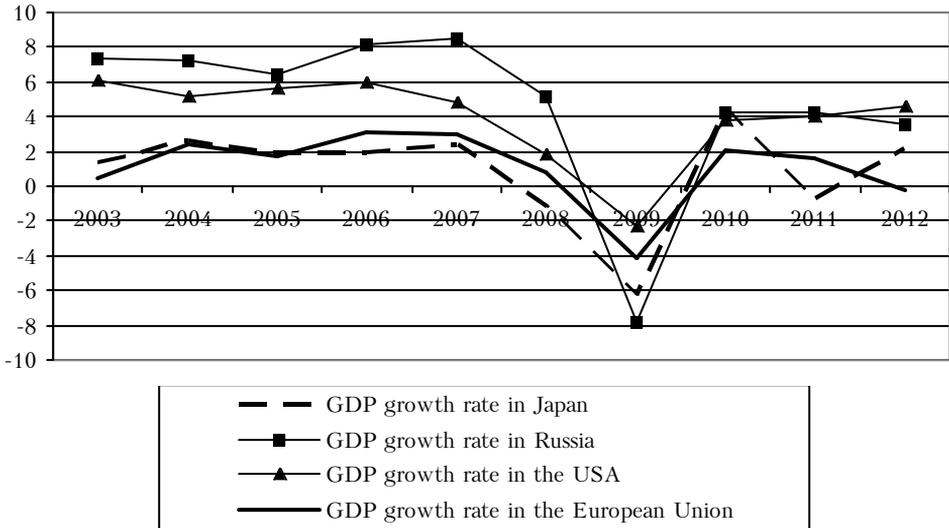
The curves on Figure 4 show that the share of budget deficit in GDP of India varies from 8 to 10%. India is actively using deficit financing for innovative development of its economy, to achieve a leading position in innovations. Budget deficits in the rest of the countries increase sharply in 2009 due to the crisis and then reduce gradually. The slowest reduction is in South Africa and Mexico. Budget deficits of Russia and Turkey reduce the fastest. In Russia, budget policy is strongly procyclical, while the expenditure growth is compensated by overplan profit from oil sales.

China and Brazil turned out to be the least susceptible to crisis. These countries could have carried out a policy of deficit financing, yet their policy is aimed at reduction of budget deficit too. China, for instance, reduces its expenditures on social payments and increases tax burden at the expense of consumption taxes. In Brazil, the low level of budget deficit is maintained by means of tax policy instruments.

To sum up, the world trends of deficit financing are as follows:

1. Maintaining the share of budget deficit in GDP at a certain target level, while increasing tax burden and reducing budget expenditures, including those for social and economic programs. This policy is being carried out in the European Union. It helps to maintain a required level of debt and budget security but does not contribute to a rapid recovery of economies. The dynamics of GDP in the European Union is moderate due to shortage of investment resources. For Ukraine, such politics is inappropriate, since its economic development is much lower than that in Europe, and it is impossible to accelerate its growth without financial support.

2. Active deficit financing of the economy by borrowing (USA) and domestic reserves (Japan). The economy of such countries is developing more actively and recovers from the crisis faster (Figure 5).



Source: Made by the author according to [http://epp.eurostat.ec.europa.eu/portal/page/portal/national\\_accounts/introduction](http://epp.eurostat.ec.europa.eu/portal/page/portal/national_accounts/introduction).

**Figure 5. GDP growth rate in the European Union, USA, Russia and Japan, 2003–2012 (% to the previous year)**

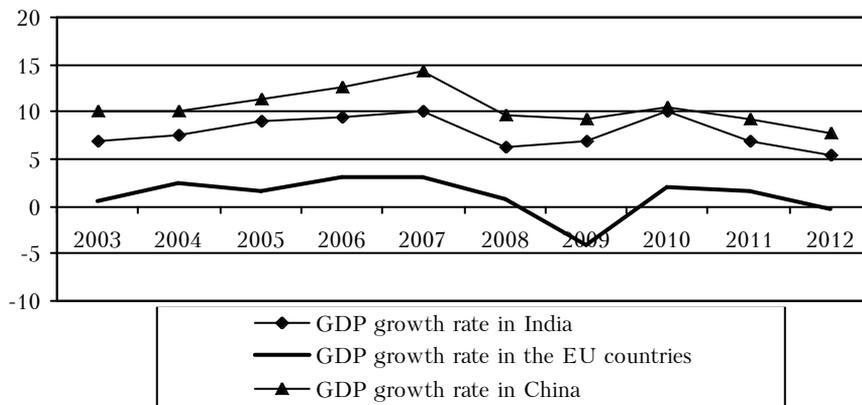
The curves on Figure 5 show that, despite deficit financing, the US economy is developing more actively compared to the European Union, proving the efficiency of debt financing of the economy, when financial resources are distributed effectively.

3. Active deficit financing of innovative development of the economy (India). Any resources mobilized through deficit financing in such case create active deficit which does not reduce debt and contributes to development of the economy. Such experience is useful for Ukraine, since it serves as an example of using active deficit of budget for the purpose of stimulating growth areas within the economy.

4. Active funding of innovation development and containment of budget deficit (China, Russia). China and Russia are able not to increase deficit financing owing to substantial natural resources (including energy ones, as in Russia) and due to cheap labor (China).

Figure 6 shows how such policy influences GDP.

The curves on Figure 6 show that, despite a long-term deficit financing of the economy, its development rate is faster than the development rate of the European countries, while consequences of the crisis turned out to be less noticeable. The growth rate of Chinese economy was leaving behind the growth of Indian, however, for the past 3 years, a slowdown has been observed due to the reduction of investment resources available in the economy. The scenarios of China and Russia's deficit financing are inappropriate for Ukraine for the objective reasons: different size of economy and substantial differences in the natural resource base.



Source: Made by the author according [http://epp.eurostat.ec.europa.eu/portal/page/portal/national\\_accounts/introduction](http://epp.eurostat.ec.europa.eu/portal/page/portal/national_accounts/introduction).

Figure 6. **GDP growth rate in India, China and the European Union, 2003–2012**  
(% to the previous year)

### Conclusions

Deficit financing of economy as an economic phenomenon definitely cannot be considered negative. Consequences of deficit financing depend not only on its volume but also on the directions of using financial resources mobilized for covering budget deficit. The limits of deficit financing are defined by the vectors of economy development (traditional or innovative), the level of the country's economic potential and sources of covering deficit, both short- and long-terms. Ukraine needs deficit financing for its economy recovery and further development, since its domestic reserves of investment resources are insufficient. Today, the volume of deficit financing for Ukrainian economy depend on the size of its foreign debt and the need to service it, as well as on the condition of trade balance, the gap between the available financial resources and the need to fund the public sector etc. The problem is that most officials, who justify the need for deficit financing, create a passive deficit of budget. Therefore, if the current policy of deficit financing is carried on in Ukraine, it may result in a debt crisis in the near future.

Taking into consideration the experience of the countries where deficit financing contributed to their economic development, Ukraine should determine those areas of economic growth which, if financed, will ensure both economic recovery and development, which, in its turn, will help accumulate financial potential of the economy and reduce the need for deficit financing.

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