The fiscal unknown: Realities of a deficit and how crippling it can be

DATELINE DOHA

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THE US SENATE had begun advancing a bill to keep the government operating beyond September 30 when funding for this fiscal year runs out. This procedural vote allows the Senate to move ahead on the bill, with a key vote expected on Friday or Saturday. As the fiscal year ends, any failure to pass a bill would force a government shutdown. Earlier, the House of Representatives had passed this legislation to fund federal agencies from October 1 to December 15 before sending it to the Senate. Besides the need to quickly approve the spending measure, Congress also is fighting over separate legislation to raise the limit on US borrowing authority. President Barack Obama has urged Congress to increase US borrowing authority without conditions and to approve the budget to keep the government open after October 1.

Many federal agencies and programmes will shutter on October 1, Day One of the coming fiscal year, if Congress and the president do not agree on a temporary budget measure. Congress must also raise the limit on government borrowing, as the US government is expected to run out of money by around the middle of October — a scenario that could make stock markets tumble and send shockwaves through the global economy.

The fiscal deficit continues to be a challenge for advanced economies. Since 1940 to 2010, gross federal debt of the US increased from $43 billion to more than $13.5 trillion and to date has touched $16.5 trillion. Students graduating in 2013 were saddled with about $35,000 in debt. On account of an ageing US population and its medical programmes, the government's annual deficits will continue far into the future, pushing the debt ever higher, unless major tax increases are enacted. High levels of public debt slow economic growth. When the government borrows money, it takes savings from the economy that otherwise could have been channelled into private-sector borrowing and investment. The cost of interest of debt will also be a concern. The US Office of Management and Budget has forecast that in 2017, interest payments on the public debt will exceed the cost of Medicare.

The Bank of Ireland building in College Green, Dublin. Ireland is one of the countries imprisoned by its high government debt-to-GDP ratio at 125.1 per cent, trailing only Portugal, Italy and Greece. — *AFP*

At the end of the first quarter of 2013, the government debt-to-GDP ratio in the euro area stood at 92.2 per cent. The highest ratios GDP at the end of the first quarter were recorded in Greece (160.5 per cent), Italy (130.3 per cent), Portugal (127.2 per cent) and Ireland (125.1 per cent). If an economy becomes overburdened by debt and relies on its creditors to keep relending it money, it risks a sudden loss of confidence, resulting in a refusal by creditors to continue lending. Greece had hidden a lot of its debts before the financial crisis, and since 2008 the government has struggled to bring its overspending under control.

European nations have been given more time to meet challenging deficit reduction targets. The IMF, in one of its discussion papers, recently had highlighted that eurozone should set up a joint budget to strengthen the bloc's ability to weather economic shocks and help its hardest-hit members avoid severe recessions. Ireland and Portugal have begun to strengthen their medium-term budget frameworks by introducing enforceable expenditure ceilings.

Although relatively low debt and deficits afford many emerging market economies there is scope to pause the fiscal adjustment process, many still have work to do to restore policy buffers and address other medium-term concerns. High debt significantly increases a country's fiscal vulnerabilities, which may rise in the future as the result of changes in the investor base and other structural factors. And the risks in some countries may already be higher than they appear because of contingent liabilities which are not recorded in debt statistics.

The author is the group chief executive officer of Doha Bank. Views expressed are his own and do not reflect the newspaper's policy.