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PUBLIC ECONOMICS AND INTERNATIONAL COMPETITIVENESS

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Modern economy is not only the sole result of the activities of million insulated market players but the resultant of the progress of reproduction organized in the framework of national economies.

Approximately, half of GDP – at least, in Europe – is the object of state redistribution. Not market players but politicians and civil servants make decisions on the use of revenues. In 2002, according to the ECB 2004 publication on monetary policy[1] the countries of euro zone spent 48% of their GDP on budgetary expenditure on the average. This ratio was 40% in Japan and 34% in the USA.

The state undertakes too high expenses

Over the past 25 years the state role-taking in advanced economies seems to have gone beyond reasonable boundaries. Violating the principle of *subsidiarity* the state took responsibility for duties which could already be performed by civil society and economic players as well. In developed countries the duality of 'the poor state and rich citizens' appeared. This economic policy resulted in a kind of unjustified redoubling in incomes since those whose costs of living were taken upon by the state, based on solidarity, were able to accumulate private savings. Eventually, in principle, *all burdens are carried by citizens* as being the ultimate carriers of tax burdens *but it is not all the same, at all, in what distribution and what loads on various generations these burdens would appear.* A great problem of modern economy is the fact that several countries are heavily indebted and they push their high debts in front of themselves.[2] In 2002 Japan's state debt was 154% of GDP! The corresponding US figure was 59.2% while the average of the euro zone was 69.2%. At the same time, the thriftiness of the Japanese is well-known; here the contrast between the poor state and the rich private sphere is really manifest.

[1] *The Monetary Policy of the ECB*. 2004. 18.
[2] *ECB 2003 Annual Report*

This means that there is a continuous redistribution between the bond holders and taxpayers in society since the permanent financing of debt stock may be expected only in a profit-making way and this can be gained from current tax revenues. The possibility of the repayment of total debt stock is out of question as this would require the budget to realize such a surplus the feasibility of which is more than doubtful. As long as financing is viable out of domestic savings, the problem is relatively smaller. The trouble is greater if *none of the economic players have net savings.* If this is the case, economic processes would come under foreign influence since *the assurance of foreign financing becomes the main problem of economic policy*; the sovereignty of economic policy will be violated, moreover, in certain cases the problem will become that of national security. Such a situation, i.e. the lack of net savings, is charateristic of Hungary today, but that had been the case in several phases of Hungarian contemporary economic policy, too. But what is more important from the aspect of world economy, there is the same situation in US economy as well.

The 'flagship' – US figures

A double deficit is characteristic of the leading state of the world which has already had to cover the fast increasing deficit of the budget out of foreign sources for long.

It may be put like this: the USA is unable to meet the demands of financing its economy out of domestic sources. All the three economic players – the companies, the population and the state – spend more than they have.

If the monetary discipline of the state is investigated, it can be stated that it has slackened considerably since 1970. According to the data of Global Policy Forum[3] the gross state debt was 0.3% of GDP in 1970. This ratio increased to 3.4% by 2004. Over the period from 1970 up till now the budget had a surplus only between 1999 and 2001, in all the other years it showed a deficit. It is not surprising that the debt stock is increasing. According to the data of the Bureau of the Public Debt[4] the peak of debt has reached $US 7869 billion. (More precisely, the publication 'Debt to Penny' says: the debt is $US 7 869 642 129 876.28...). In 1987 the state debt was 'only' 2350 billion but by 1995 it grew more than double, reaching 6786 billion by 2003. In the fall of 2004 the Congress approved a newer ceiling again: the sum could be raised to 8800 billion. By December 31, 2004 the debt stock reached $US 7596 billion and by the end of the year the debt ratio to GDP made up 61%. The acceleration of indebtedness can be seen clearly.

The loan burdens of the population have grown drastically in the USA. While in 1966 household debts made up $US 360.4 billion, according to FED statistics this figure climbed up to 1110.5 billion by 1978, then it trebled over almost a decade, reaching $US 3039.6. Over the following one-and-a-half decade there had been an acceleration, too: by 2004 the total debt of US households reached $US 10 276.2

[3] *Congressional Budget Office*. Publ. by Global Policy Forum http://www.globalpolicy.org/socecon/crisis/2003/statedebt

[4] Bureau of the Public Debt, The Debt to the Penny http://www.publicdebt.treas.gv/opd/opdpenny.htm

billion the bulk of which – 70% of it – is mortgage credit and the smaller part of the rest is consumer's credit.

Traditionally, the company sector operates with great indebtedness in the USA. Surprisingly, it became a net creditor in 2002 and 2003 what is a strong deviation from historic trends. This happened due to the considerable reduction of investments, thus we have no reason to be glad at all. By 2004 the data became negative again: 'the order was restored'... Companies demand sources again.

Thus, owing to the insufficient stock of domestic savings financing may come only from abroad. Recently, however, we have witnessed an interesting phenomenon: the corporate sphere has been avoided by financial investors. Direct investments have declined drastically. As has been reported by US Bureau of Economic Analysis,[5] the value of direct investments dropped from $US 127.9 billion to 73.9 billion from the first quarter of 2004 to the second one. But the USA had no financing problems because foreign demand on government bonds substituted for the deficit. The latter, i.e. demand on government bonds, grew by 18.9% in the quarter mentioned. The treasury bonds bought by Asian monetary authorities widened the possibilities of financing the balance of payments for the USA significantly.

However, the world is full of dollars. Investors would like to differentiate their foreign currency portfolio; they want to get rid of their dollars. This pushes down the exchange rate of dollar and this is why *there is a danger for a serious breakdown* of the still dollar-based foreign currency system of the world.

No wonder, that IMF has warned, repeatedly, its member country – and at the same time, its greatest shareholder *who did not react to this warnings at all* – to strengthen the budgetary discipline. Prognoses indicate gloomy pictures if the present US economic policy is continued but there are no signs for change. The budgetary equilibrium will deteriorate if the government maintains its policy for tax reduction and the growth of expenditure. The former is compelled by the requirement of competitiveness and the economic interests of power groups, and the latter is forced by the increase of military and social expenses. And if we have in mind how low the efficiency of US health care is as well as the fact that the age-group of the baby-boom retires, it seems to be unambiguous that the increase of social expenditure will be unavoidable.

The bumpy road of redressing the balance

To balance the budget is very difficult. Since the early 1980s the world has been struggling with a serious crisis of overdistribution[6] *The world-wide imbalance* emerged for different reasons in various groups of countries. In developed countries welfare expenses went beyond economic productivity, while in developing countries deficit appeared due to community investments which were forced by the requirement of catching up, and in Hungary both factors played a role. (It should be emphasized, overspending is always relative. The economic policy in the years of

[5] *US Bureau of Economic Analysis*. Publ. by ECB Financial Stability Report. 2004. 18.

[6] Botos, Katalin: *Világméretű egyensúlyhiány*. Közgazdasági és Jogi Könyvkiadó, l987.

Kádár regime can be blamed not for the too high living standard but for the low productivity of economy what was covered by Comecon trade to some extent but came to light at the time of the change of regime.)

The world-wide crisis of overdistribution, budgetary deficits and considerable state debts mean that world economy consumes *to the detriment of future generations.* Even if the growth of indebtedness is managed to halt, there will be a layer of society which will have an income, in compliance with the concept of capitalist exploitation described by classic socialism, that it will do nothing to achieve this; it will provide no assessable service to fellow citizens and players of business life in the given period of reproduction. But overconsumption on the future account cannot be for ever increased due to the fact that on the expenditure side of the budget debt service plays too great a role, i.e. this 'should be made some place'.

This means that *expenses should be cut*. It was Reagan's economic policy and that of Thacher's that pushed the state out of the owner's role first. Thus, the privatizing governments gained considerable non-recurrent revenues[7] that were consumed quickly by the budget, the central or local level of public finances.

This happened in Hungary after the change of regime as well. The monies of local governments coming in from the sales of flats melted away quickly: 'Where the snow of yesteryear has gone...', although the proceeds of the central state privatization were used to reduce the debts of the country, to refund the sate debts abroad to a significant extent. (This might have a positive impact on outlays to some degree since the decline of debt stock reduced current interest burdens but this impact was only short. The high level of state debt with the concomitant high level of budgetary expenditure was restored soon, although that was not a direct foreign debt for the Hungarian government at least; it appeared in HUF but on the Stock Exchange where there were government bonds, and liquidity was assured by foreigners. Thus, the overindebtedness of Hungarian budget continued to depend on foreigners indirectly.)

In the longer run solution must be the reduction of recurrent expenses. Although, it should be noted, that the aim of selling the flats of local government was to get rid of recurrent expenses as the costs of the reconstruction were due. But this step restrained only the further growth of expenses; more would be wanted, i.e. the cut of the existent level of expenditure would be necessary.

After the change of regime the budget ceased to subsidize companies to a great extent. Indirectly, now it supports only a few firms which were privatized (e.g. the pharmaceutical industry through the support of the price of medicines).

However, there are still the infrastructural establishments there. The obligations of their maintenance and enlargement as well as the 'burdens' of educational and social allocations consume immense amounts in Hungary just like in many European economies. These tasks financed out of public sources have the same fate as other state expenditure on economy: *the state tries to privatize them.* At least, it seeks to get rid of raising the non-recurrent costs of expansion since it 'played the card' of indebtedness maximally (according to the Maastricht criteria).

[7] YERGIN, D. – STANISLAW, J.: *Commanding Heights.* A Touchstone Book, New York, 2003.

Tax and contributions

Would the budget be balanced again through the increase of revenues?

Of course, this question is ‘poetic’ in modern world economy. If we study the statistic data of international power centres – USA, Japan and the euro zone –, the increase of public burdens is not viable. We can see that, compared to the other two power centres – Japan and EU – the USA imposes much lower indirect taxes and social security contributions on economy In a globalized world the competition in Far East makes us to decrease the scales of burdens. The socio-economic systems of China, India and the other tigers do not take into account the costs which, esp. Europe does. Where there is no social market economy the significant part of services is provided either by large families or nobody. You may sleep under the bridge. You may sleep, give birth to a child or die in the street. Nursing a sick family member and the education of children occur within the family, so to say, ‘free of charge’. There is no obligatory income redistribution comparable to the European level with the competitors to the European Union at all. It cannot be said there is an absence of efforts to change this situation in these countries. Moreover, there are enviable positive results and interesting experiments. It is a positive example that in the USA – and in Japan, too, – the activity ratio is much higher, i.e. a higher ratio of people work, start to work and retire later. However, this derives not only from mentality but constraints as well. In the USA people have to work as long as they can because, basically, they must rely on themselves in their old age, too. Social security is far less extensive than in Europe. But this makes possible a lower contribution level which assists competitiveness. As compared to Japan and the USA, in Europe people retire earlier and enjoy their pensions – and, probably, the yield of their savings as well. It is this duality that seems to be unsustainable in the future.

In a global market high public costs makes production uncompetitive. Imported goods which have been produced without similar burdens, or probably, with lower wages flood the USA but Europe as well. The highest commercial liabilities of the USA derive from Japan and China, however, among its ten greatest import-partners there are Malaysia, Thailand, South Korea and Taiwan. (From Europe only FRG and Italy managed to get in this circle, obviously, for other reasons)[8] Asian quality of goods may leave much to be desired but in the countries (e.g. in Hungary) where there is a wide layer of society with low income, the products of Far East are purchased because people are able to pay only for them. And *the domestic producer goes bankrupt.* Further on, parallel to the ageing of population pension systems cannot be financed even besides the present level of contributions. Thus, the reform of the West-European pension systems and the decrease of the payments (since the growth of revenues, as has been seen, is unfeasable) are unavoidable. By the way, this problem is primarily a political and not an economic one. Inevitably, the social allocations planned grandiously high will be cut by politicians what will be followed by discontent. The problem is not new. Half a century before Wilfried Schreiber, advisor

[8] SCOTT: *Are we trading away our futures?* Economic Policy Institute http://661029104/sarch?g=cache:6aryv36XS8Iwww.ep

to Adenauer in questions of social security directed attention to the fact that social security expenses were calculated somewhat high. The level of guaranteed pensions is high and that load would be unbearable by German economy due to the expectable demographic processes. However, Adenauer's reply was like that: „It is interesting what you say... But who must win the election: You or me?"[9] This much about political foresight... It is highly probable that for the time being, reform in this field is inevitable in Germany.

The political difficulties of the task are obvious. The rights acquired cannot be taken away. What would be the opinion of the countries where the strengthening of the middle class has not happened owing to the 'experimentation of the socialist economic system and where even since the change of regime there has not emerged such private wealth or incomes proper to accumulate such with wide layers of society on which the costs of self-care could be imposed. What shall we say to it here in Middle Europe?

Modern capitalism has been caught by its own trap: either it performs its self-restrictive reforms correcting downward what will be very difficult politically, or it will be compelled to withdraw global liberalization. The cheap products flowing from China and the countries of Far East will be limited or we take over the practice to impose the burden of social tasks on families which originates from eastern civilizations or from the age of pre-capitalism.

There is an abundant literature on the topic that economy financed by modern system of credits formulates a short-term approach in participants and makes production more expensive without any reason. If one need not pay for everything that can be done by a natural division of labour within a family (child care and minding the old, sewing, cooking, washing, cleaning etc.) too, the countervalue of these activities are not calculated in wages. Yes, basically, this is the exploitation of women's work, if you like. However, in societies where little, moreover, large families are the basic units of society, this is not or not naturally considered as such.

Of course, it would be a theoretical solution if developed countries acknowledged an international division of labour where the whole mass production is ceded to the dynamically developing countries. However, it is dubious that the inner structure of production of individual countries would be able to transform with the speed wanted and absorb labour that becomes superfluous in this way. Now as unemployment became No 1 political problem in Europe, it is hardly believable that the state would look on 'the distortion of market' passively.

Summing up

World economy is at the cross roads in the long run. The development of welfare society and the liberalization of international markets cannot be continued at the same time. The developed world will be compelled to pursue a self-restrictive social policy if it does not want to lose the advantages which it enjoys owing to the liberalization

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[9] HOMEYER, J: *Der Staat steuert niccht, er rudert*. Der Katholischer Unternehmer, Köln, 1999.

of international trade. But this is forced by demographic tendencies as well. The overconsumption of the present generations can be hardly imposed on the account of future generation anymore. If the world's leading power affords this to itself in the present pace, world economy is going to collapse. If a small and open country like Hungary does that, the danger of collapse will jeopardize, primarily, ourselves. For us this trouble is just enough...