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BUDGET DEFICIT: INDICATOR OF FINANCIAL RELATIONS WITHIN THE FINANCIAL SYSTEM

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Abstract: *The budget deficit has become a widespread phenomenon in most states of the world, as their demand and financing needs are often higher compared to the revenues obtained from taxes and fees. In this context, in the given article, the authors propose to analyze the theoretical and conceptual foundations of the budget deficit as an indicator of financial relations within the financial system, as well as its causes, consequences and sources of coverage. At the same time, the dynamics and evolution of the budget deficit of the Republic of Moldova, as well as their financing sources, will be analyzed. The research methodology related to the given article is represented by the method of analysis, synthesis, comparison, graphic method and data interpretation method, etc. As a result of the given research, the optimal methods of financing the budget deficit are to be identified as well as the situation of the budget deficit in the Republic of Moldova is to be analyzed.*

Keywords: financial system, public finances, state budget, budget deficit, financing sources

JEL Classification: E44, G10, H20, H61, H62, H70

1. Introduction

The *financial system* is one of the pillars of any national economy, as it contributes to the provision of facilities for carrying out financial transactions, channeling funds from depositors to borrowers, providing the means for businesses and households to manage financial risk, etc. The successful performance of these functions contributes positively to prosperity and economic development. A financial system can be considered consolidated, if it is able, effectively, to attract and place funds in the economy, ensures the management of financial risks, absorbs negative economic shocks, in which there are no signs of financial instability.

The concept of the financial system is very complex, in the specialized literature (Băcescu-Cărbunaru, 2008; Ковалев, 2006; Cobzari, Baurciulu, 2001) being met several interpretations of it, as a result of the analysis of which the manifestation of the financial system was found from the following aspects and forms:

- system of financial relations;
- system of funds of financial resources;
- system of financial plans;
- financing system of the national economy;
- system of institutions.

From the perspective of *financial relations*, the financial system manifests itself in the process of establishing, distributing and using financial funds, thus distinguishing two large financial subsystems: *the public financial subsystem*, the main components being: the state budget, local budgets, state social insurances; credit (with the participation of some public entities), insurance of goods, persons and civil liability (through state owned enterprises), finances of enterprises and other public entities; and the private financial subsystem, composed of the finances of enterprises and other private entities, bank credit (private), goods and private social insurance, personal and civil liability insurance (private), household finances.

At the macroeconomic level, the financial system involves the redistribution, through public finances, of the gross domestic product (GDP), a fact that is quantified by the establishment of budget funds, as well as the distribution and use of these funds to satisfy public needs, those of wider national or local interest. The relationships that are formed around public finances involve, on the one hand, public authorities, and on the other hand, individuals and legal persons, in the role of taxpayers to the establishment of funds and/or beneficiaries of public goods and services financed from these resources.

The exercise of public finance functions (allocation and distribution of resources and regulation of the economic life of the state) is carried out through the *budget*. The state budget is an element of public finances, in particular, and of the financial system, in general, manifested in the form of financial relations, of significant importance, having multiple meanings: multitude of operations and specific financial flows; the most important law debated annually by the legislative forum; synthesis of different economic, social and political options; means of manifestation of the financial-budgetary constraint; negotiation tool with various financial bodies, etc.

2. Budget Deficit as an Indicator of the Financial Relations

2.1 Theoretical Aspects Related to the Budget Deficit

Given that the state budget is an important benchmark for reflecting the degree to which the state is involved in the economy and social life, as well as the capacity of the national economy to contribute to the establishment of the financial resources necessary for the state, any country tends to balance it, which often becomes impossible. Thus, as a result of an excessive demand for public financial resources, compared to the funds that can be constituted at the state level from taxes, fees and other revenues, a public financial imbalance appears. This imbalance, determined by the difference between budget revenues and expenditures, can take the form of a *budget deficit* (negative budget balance), budget surplus (positive balance) and budget balance (zero balance).

The budget deficit has become, for some time now, a common phenomenon in many states on the background of increasing public spending. Therefore, in the current conditions of economic activity, in which the need for financial resources exceeds the existing funds, the drafting of budgets at any level is one of the primary concerns, especially in the part related to respecting the

principle of budget balance. Although significant efforts are made through various policies, in most cases, the budget balance is not achieved automatically by covering budget expenses with budget revenues, which implies that the budget is drawn up with a financing deficit (Molănescu, 2011). The existence of the budget deficit is generated by several factors, such as:

- the decrease in the volume of economic activity, which leads to a decrease in the income of individuals and legal persons, as a result, there is a reduction in the taxable base and, consequently, a decrease in budget revenues;
- increasing government spending in order to implement social programs (spending on unemployment, with assistance for people with special needs, etc.);
- increase in public expenditures associated with infrastructure development;
- reducing the tax rate in order to stimulate the activity of economic agents;
- the low level of tax collection (Balan, 2020).

The existence of a budget deficit does not always reflect a difficult economic situation, and the absence of a deficit does not mean that the country's economy does not face problems and that it has a dynamic development. A good part of the economically developed states had and still have a high level of budget deficit. This is not necessarily a problem when it is fully reflected in investment spending and, in particular, in the construction of infrastructure and is covered by safe financial resources, without resorting to inflationary monetary issues. Thus, the existence of the budget deficit can be determined by the government's intention to make public investments in the development of some sectors of the economy with the aim of achieving progressive changes in the structure of social production.

However, most frequently, the budget deficit reflects crisis situations in the economy, the worsening of the economic and financial indicators of agents' economic activity, the inefficiency of the tax system, etc., in which case, the adoption of urgent measures by the government in order to stabilize the economy is necessary, reforming the credit-financial system, adjusting the budgetary-fiscal policy. For these reasons, all countries tend to balance the budget or, at least, do their best not to exceed the maximum allowed limit of the budget deficit, which, according to world experience, must be 2-3% of GDP, 5% of national income, or 8-10% of budget expenditures (Balan, 2020).

2.2 Financing Sources of the Budget Deficit

Regardless of the causes of the budget deficit appearance or existence, it must be countered, a fact that can be achieved by promoting economic growth measures, maximizing the efficiency of the public revenues use, connecting expenses to the real possibilities of the national economy, simplifying fiscal regimes, thus determining improved economic conditions and a confident business environment in state policies. If the budget resources are oriented to the development of industry, the modernization of agriculture, the construction of communication routes, environmental protection, etc., then, in the future, they will contribute to the increase of material production, the development of the business environment, the creation and employment of jobs and, in the end, to the GDP increase. If, however, the budget resources are oriented towards financing current expenses, subsidizing unprofitable production, then the budget deficit will inevitably lead to the increase of negative trends in the development of the economy.

Although the business environment development is the safest method of countering the budget deficit (Stratan A., Manole T.), its achievement and effects take time, as states are required to identify ways for covering the deficit with immediate effects. In this sense, the specialized literature presents four ways of financing budget deficits (table 1).

Table 1. Financing methods of budget deficit

No.	Methods	Particularities
1.	Tax increase	it implies increasing the volume of fees and taxes in order to reduce budget imbalances. Due to the generally negative influences in the economic activity, in almost all cases an increase in taxation, through the direct effect of diversion of financial resources towards the redistributive consumption of the state, leads to the weakening of the development effort, by weakening the capacity to invest, and to reducing the solvent demand of intermediate and final consumers, with an unfavorable effect on the demand-supply ratio on the market.
2.	Reducing budget expenses	practicing a restrictive budget policy, at least by reducing government consumption, can have positive results on the public financial balance in the short term. The promotion of such a long-term policy will be followed, with certainty, by negative consequences that will affect economic growth. A restrictive budget policy can be implemented in crisis situations, when states face excessive public deficits that usually lead to increased inflation, exchange rate fluctuations and affect the entire economic system.
3.	Monetary issue	this method generates an uncontrolled and unjustified increase in the monetary mass, aggravating the inflationary phenomenon in the economy in the immediate term. The process of monetizing the budget deficit is clearly inflationary until the moment when the economy moves towards a new long-term equilibrium with a high level of prices. If the government decides to maintain this policy for a longer period, a corresponding increase in the money supply will result, meaning a continuation of inflation.
4.	Public debt	it involves accessing the necessary financial resources by resorting to state loans. The primary element that must be the basis of this decision is the need for the medium and long-term "profit" achieved by financing public expenditures to be large enough to cover the debt service. Also, the loss of utility that the market bears by depriving it of the resources used to cover the deficit must be covered, and the public decision-makers must maintain their credibility following the recourse to the state loan.

Source: elaborated by the authors based on (Molănescu, 2011; Manole, Stratan, 2016)

Regardless of the consequences that may occur, however, the most widespread way of covering the budget deficit in world practice is to finance it through internal and external state loans, which form the internal and external public debt. Unlike the other financing methods, the financing of the budget deficit through public debt does not oblige the state to undertake drastic measures, such as increasing taxes, reducing and optimizing public expenditures, and does not generate any inflationary processes in the economy.

Thus, in the conditions where the budget deficit represents a variable of flows, and the public debt represents a variable of stocks, every time at the end of the year the state faces a

budget deficit and requires funds for financing, accessing and obtaining them affects the level of public debt. At the same time, according to European Union regulations, the limit level for public debt, as a share of GDP, must not exceed 60%.

2.3 Budget Deficit and Public Debt at International Level

Over time, the governments of the world's states have always faced challenges in the process of ensuring the financial resources necessary for economy financing and development, the budget revenues accumulated by the state being insufficient to cover the budget expenses and in recent years, the given problem significantly sharpened. In addition, as communities around the world struggled to contain the spread of the Covid-19 infection and manage the health situation, including the human costs of the pandemic, governments around the world implemented a wide range of response policies to mitigate the most serious social and economic impacts of the pandemic.

Thus, given the governments' financial intervention in the economy to limit the impact of the crisis on households and businesses, the budget deficit related to 2020 increased significantly, its share in GDP constituting 10.46% in the case of developed states, 8.24% - developing states and 4.33% for under-developed ones (figure 1).

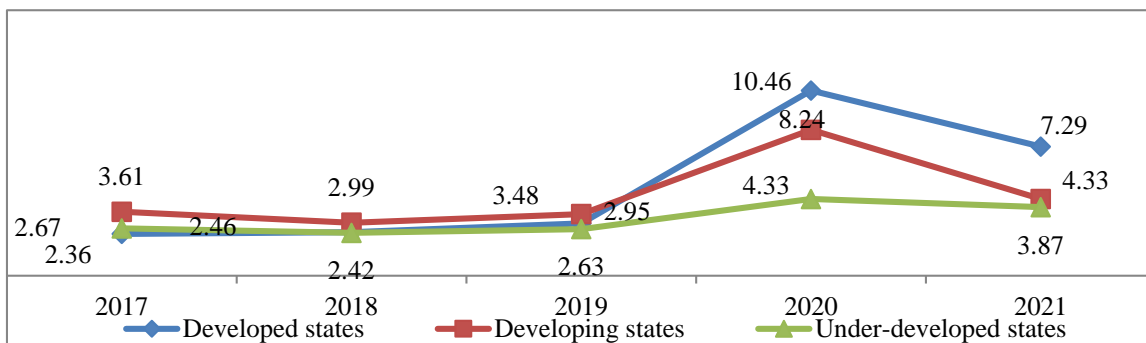


Figure 1. The budget deficit dynamics of world states in the period of 2017 - 2021, % of GDP

Source: elaborated by the authors based on (Kose, Nagle, Ohnsorge, Sugawara, 2021)

The most dramatic increases, compared to the period of 2017-2019, of the share of the budget deficit in GDP related to 2020 can be seen in developed states (by about 7.5 p.p.) and in developing countries (by about 5 p.p.). In 2021, a decrease in budget deficits is observed, given that in most states economic activity has slowly started to recover. Thus, in 2021, the share of the budget deficit in GDP of the developed states was reduced, compared to 2020, by 3 p.p., of developing states - by about 4 p.p., and of the under-developed ones - by about 0.5 percent. In order to finance the recorded budget deficit, the states resorted to loans, the level of public sector debt increasing analogously to the level of the budget deficit (figure 2).

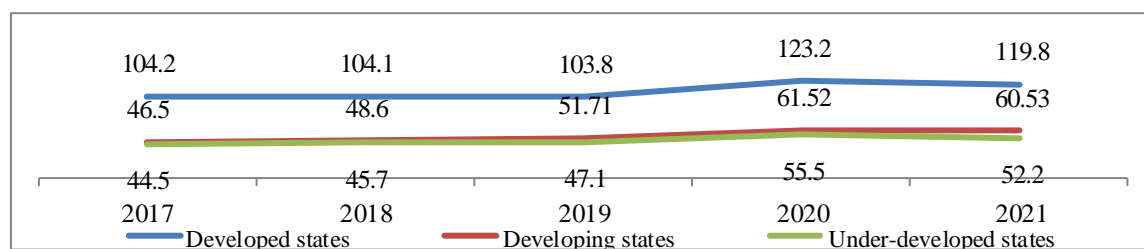


Figure 2. The public debt dynamics of world states in the period of 2017-2021, % of GDP

Source: elaborated by the authors based on (Kose, Nagle, Ohnsorge, Sugawara, 2021)

Therefore, if in 2017-2018, the share of public sector debt in GDP remained at a relatively constant level, from 2019 it began to increase in the case of developing and under-developed states, considerable increases (by about 10 p.p. in the case of these and by about 20 p.p. in the case of the developed ones) attesting in 2020 compared to 2019. Along with the decrease in the level of the budget deficit in 2021, and respectively, in the need to finance it, the public debt level was also slightly reduced at a global level, its share in GDP being about 4 p.p. lower in relation to the values related to 2020. It is also worth mentioning that the share of public debt in GDP of developed states has far exceeded the recommended limit of 60%, this situation being characteristic for the entire analyzed period.

3. Budget Deficit in the Republic of Moldova

3.1 Legislative Aspects of the Budget Deficit and its Financing Sources in the Republic of Moldova

In the Republic of Moldova the limit of the budget (national public budget - NPB) deficit, constituted by the deficits of the component budgets of the NPB: the state budget, the state social insurance budget, the compulsory medical assistance insurance fund, local budgets), established by legislation, is 2.5% of GDP. Exceeding the predetermined limit level is allowed when there are real financing sources for capital investment projects and for their capitalization capacities. At the same time, exceeding the limit of 2.5% of GDP can only be allowed for a fixed period, of at most three years, and only in case of:

- natural disasters and other exceptional situations that endanger national security;
- decline in economic activity and/or if the level of inflation exceeds the forecasted/planned level by 10 percentage points;
- emergence of the need to cover the debit balance of the general reserve fund of the National Bank of Moldova, as well as in case of a systemic financial crisis, for the capitalization of banks.

At the same time, according to the legislation, the financing sources of the NPB deficit are formed from: operations with debt instruments; operations related to the sale and privatization of public patrimony; operations with the balances in the budget accounts; other operations with financial assets and budget liabilities (Law no. 181/2014).

3.2 Analysis of the Budget Deficit and the Related Financing Sources in the Republic of Moldova

The Republic of Moldova, from its independence until now (1991-2021), is facing, practically continuously, with a lack of budgetary resources necessary to finance activities of major importance for the country, for society, such as: health, education, social assistance, infrastructure projects and other spheres of economic importance. Thus, along with other countries of the world, the Republic of Moldova faces the phenomenon of the budget deficit. The recession of 2020 caused by the COVID-19 pandemic, the severe drought of 2021, but also the energy crisis of the fall of 2021, which produced a chain increase in the prices of both regional energy resources and product prices supply at the internal level, generated new challenges for the authorities and the business environment, which increased their pressure on the balanced execution of the budget, generating a significant increase in the country's budget deficit.

According to the reports of the Ministry of Finance regarding the execution of the NPB, the largest deficit was recorded in 2020, its value registering 10,619.8 million lei, which is about three times more compared to 2019 (figure 3).

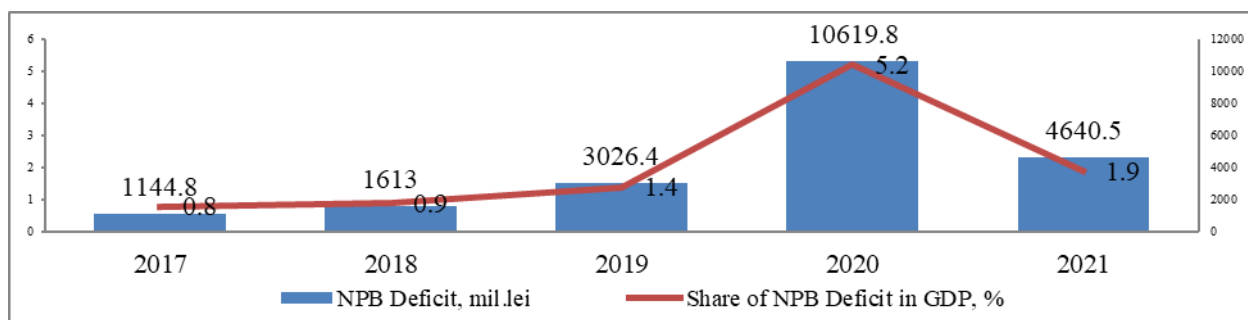


Figure 3. Evolution of NPB deficit of the Republic of Moldova in the period of 2017-2021

Source: elaborated by the authors based on (Ministry of Finance of the Republic of Moldova, 2017-2021)

Although during 2021, the Republic of Moldova faced a drought and an energy crisis that generated several unfavorable reactions in the chain (price increase), the NPB deficit related to 2021, as a result of the execution of the NPB, was 4,640.5 million lei, 5,979.3 million lei less compared to 2020. This decrease in the NPB deficit value is due, in large part, to a series of increases from an economic point of view against the background of the relaxation of the COVID-19 restrictions, the acceleration of the growth of domestic consumption, of the investment activity and, respectively, of the revival of the economic activity.

As a share in GDP, it can be observed that from 2017 until 2020 the deficit, recorded as a result of the execution of the NPB, recorded an upward evolution, from 0.8 and 0.9 percent in 2017 and 2018, respectively, until to 1.4 and 5.2 percent in 2019 and 2020, respectively. In 2021, the share in GDP of the deficit as a result of the execution of the NPB registered 1.9%, which is 3.3 p.p. lower in relation to the share related to 2020.

Analyzing the financing sources of the state budget deficit³⁶ of the Republic of Moldova, it can be found that operations with debt instruments represent the main source of its financing (table 2).

Table 2. The dynamics of state budget deficit and the structure of its financing sources in the period of 2017-2021

(mil. lei)

No.	Indicators	2017	2018	2019	2020	2021
1.	State budget deficit	1 531,7	2 275,7	3 106,0	11 134,9	4 733,1
2.	<i>Financing sources:</i>					
2.1	Financiar assets	-250,1	670,0	892,3	-288,5	-2 257,8
2.2	Debt	3 421,2	991,6	621,9	12 980,1	11 917,5

Source: elaborated by the authors based on (Ministry of Finance of the Republic of Moldova, 2017-2021)

In the part related to financial assets, it can be observed that in 2017, 2020 and 2021, they did not contribute to financing the budget deficit, but on the contrary, generated financial pressure on it, the only source of financing the budget deficit during these years being the operations with debt instruments.

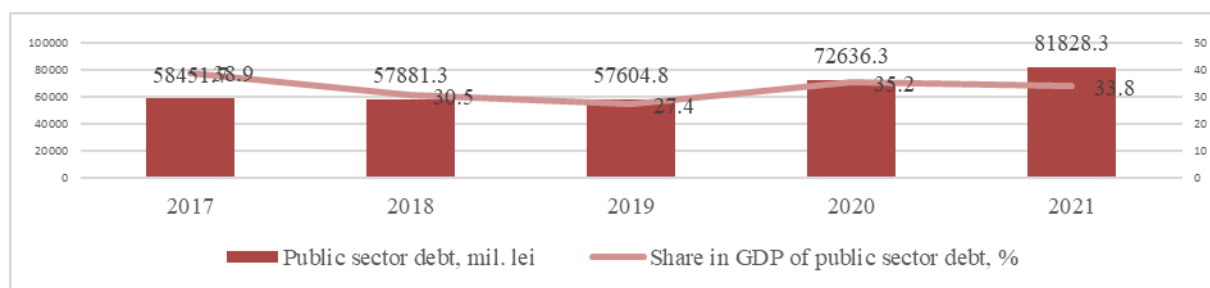


Figure 4. Evolution of public sector debt of the Republic of Moldova in the period of 2017 - 2021

Source: elaborated by the authors based on (Ministry of Finance of the Republic of Moldova, 2017-2021)

In this context, the public sector debt balance of the Republic of Moldova recorded the most significant values in 2020 – 72,636.3 million lei and in 2021 – 81,828.3 million lei, a fact that is explained by the considerable level of the NPB deficit (figure 4). As a share of GDP, public sector debt in 2021 constituted 33.8%, which represents 1.4 p.p. less than in 2020 and by 6.4 p.p. more compared to 2019.

4. Conclusion

Considering the current economic realities and the continuous and growing demand for financial funds from the state, the resources that are formed from taxes and fees are often not enough to cover this demand, the budget deficit thus becoming an increasingly common phenomenon among the states of the world, and an increasingly characteristic indicator of the financial relations as a manifestation of the financial system as a whole. Statistical data show that,

³⁶ Given that the legislation stipulates that transfers are made from the state budget (with general, special purpose, in order to cover the insufficiency of revenues) to the other components of the NPB, there were analyzed the sources of financing of the state budget deficit.

against the background of the latest events that took place at the global and regional level, the value of the budget deficit has increased significantly, with states resorting to state loans to cover it. Being the most widespread method of financing the budget deficit, since it does not require an increase in taxes, which would affect the living standard of the population, it does not imply the reduction and optimization of public spending, including by giving up certain investments or projects intended to contribute to the economy development, as well as does not generate any inflationary processes in the economy, the amount of public debt at the global level register considerable values, exceeding the recommended limits. The Republic of Moldova, along with the other states of the world, faced record values of the budget deficit in 2020, with a slight reduction in 2021 due to the recovery, to a certain extent, of the economic activity. The main source of financing the budget deficit in the Republic of Moldova are loans, and the increase in the budget deficit generated, respectively, an increase in the level of public debt. However, despite this increase, its share in GDP falls comfortably within the limit level established by EU practice (60%), and its amounts did not exceed the planned values that were established by the annual budget laws during the analyzed period.

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