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The Delicate Art of Balancing the Budget

By Sam Vaknin, Ph.D.

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Government budgets represent between 25% and 50% of he Gross Domestic Product (GDP), depending on the country. The members of the European Union (Germany, France) and the Scandinavian countries represent the apex of this encroachment upon the national resources. Other countries (Great Britain, to name one) fare better. But even the more developed countries in South East Asia do not clear the 25% hurdle.

The government budget, therefore, is the single most important economic decision, the most crucial economic event every (fiscal) year.

The government finances its budget mainly by taxing individuals and corporations. Ultimately, households pay the bill. Even corporations are owned by individuals and earn their money by selling products and services to individuals. Higher taxes are likely to be passed on to customers or to employees. There are numerous kinds of taxes, regressive and progressive, direct and indirect, on earnings and on property - but they all serve to finance the budget.

Another method of financing the budget is by borrowing either in the capital markets (by selling bonds as the government of the USA does) - or by "voluntarily" deducting part of the wages (as Israel used to do until a decade ago). Such borrowing has grave repercussions: the national debt grows, debt service (repayments of interest on the debt plus the principal of the debt) consumes more and more of the national resources and the government crowds individuals and - more importantly - businesses out of the credit markets. In other words, the money that is lent to the government is not available to finance consumption, investments and working capital for businesses. The competition on the scarce resource of capital increases its price, interest rates. Government borrowing has disastrous economic consequences in the long term: reduced consumption, heightened interest rates, stagnant investments - all leading to recession and negative or reduced growth rates.

Recognizing these unfortunate results, governments the world over have been converted to the new religion of balanced budgets or, at least, reduced and controlled budget deficits.

The two best known examples are the United States and the European Union.

One of the things which used to distinguish between political camps in the USA -

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Democrats versus Republicans - was their attitude towards the role of government in the economy. The Democrats believed in an active government, whose role it is to ameliorate the excesses of the markets. This logically led to less hysteria over the size of budget deficits. The Republicans firmly believe in Bad Big Government and in the overriding necessity to constrain it and to abolish as many of its functions as politically and economically feasible. Small Government was a pillar of the treaty with the people which led the Republicans to their landslide Congressional victory in 1994.

It is an absurd that it was a Republican president (Reagan) who was responsible for the biggest increase in the national debt since the USA was established. He reduced the interference of government in economic life mainly by reducing taxes - without the commensurate slimming down of government itself. The result was apocalyptic: enormous twin deficits (budget and trade), a collapse in the exchange rates of the Dollar against all major currencies, recession and the steepest stock market crash in 1987.

Today, the USA owes 5 trillion USD. True, this is only 60% of the GNP - but this time statistics is misleading. The interest payments on this "benign" level of debt amount to 15% of the budget, or 250,000,000,000 USD per annum. This is more than any other expenditure item in the budget, barring defence. And it is getting worse.

This, however, belongs to the past. Clinton is as much a Republican as any and both parties share the conviction that the budget must be balanced by the beginning of the century. It seems that it is well on its way there. The projections of the objective and reliable Congressional Budget Office (CBO) are positive: the budget will be balance shortly, long before it was projected to do so.

But it was an American, Benjamin Franklin, who once (1789) said: "Only two things are certain in this world - death and taxes". This spectre of a balanced budget already provokes interest group to pressurize the administration to be less tight fisted and possessed more of a social conscience.

Nowhere was the new "less deficits" doctrine more apparent than in the Maastricht Treaty and, especially, in its criteria. The latter determine which of the member countries of the EU will join the Euro single currency zone in the first wave of entrants in 1999. One of the more important criteria is that the deficit in the government's budget will not exceed 3.0% of GDP ("three point zero" - emphasize the Germans who are very worried about the stability of the currency which will replace their treasured DM).

As a result of this rigid criterion, governments have increased taxes (France), imposed one time levies (Italy), engaged in creative accounting (again France with many others) or unsuccessfully tried to do so (the failed attempt to revalue the gold reserves in the coffers of the Bundesbank in Germany). Some were aided by buoyant economies (France), others by favourable public opinion (Italy), yet others by farsightedness (Germany's Kohl). All of them pay a dear economic, political and social price. By restraining the budget deficit, they induce recession or fail to encourage budding economic expansions. Unemployment rates remain stubbornly high, so do interest rates.

This is the price of adhering to an economic fad.

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Balanced or low deficits budgets are a good things when the economy is roaring ahead. But there are certain things that only governments can do: defending the country, maintaining law and order, disaster relief, ensuring market competition. One of the more important functions of any administration is to act anti-cyclically, to encourage economic activity in times of recession - and to hold the economic horses when they go wild. A government cannot do this when its hands are tied behind its back by a totally arbitrary limitation: no more than 3% budget deficit (why 3? why not 2.65%?). This Maastricht criterion will prove, in the long run, to be lethal to the very idea of a European Union.

What is a budget?

It is a program. It charts the government's expenditures and allocates its resources for a period of one fiscal year. Some fiscal years start and end in January (Israel), others in October (the USA). But budgets always relate to fiscal years because of their dependence on tax revenues. Modern government budgets make a clear separation between current expenditures and the development elements. These were mixed in the past and this served to cloud issues and to disguise gross misuse of funds.

But this structural separation did not change anything basic. Budgets are statements, mainly of policy. The budget delineates clearly - and if it doesn't do so, it surrenders through careful reading and analysis - the political, economic and social priorities and goals of the government which prepared it. Politicians can talk a lot about the importance of this or that - but it is only when they put (other people's) money where their mouth is that an indisputable priority is established. Money talks (loudly) and the budget proclaims the true face of the government which conceived it.

In this sense, a budget is also a monitoring tool. By comparing financial projections, finances allocated to specific purposes in the budget - to the actual use made of the funds and to the extent that they were expended, it becomes clear whether the government "has kept its word", "changed its mind", or "reneged on its promises". A budget is a promise, it is a contract between the elected government and the nation, it is approved by parliament and has the status of a law. A budget can be altered only through a vote in parliament. It is a document of unparalleled importance, second only to the constitution.

Still, budgets (moreso than constitutions) are like living organisms:

As circumstances change, new priorities and emergencies alter the allocation of resources. The budget is based on economic projections and predictions, not all of them successful and come true.

This is why additional or supplementary budgets are introduced by governments during the fiscal year. These are updated versions of the original budget. They reflect the changed reality better than the outdated original. They help to redefine national priorities, reallocate resources, modify national spending.

These budgets usually include tax increases, new economic or social programs, or additional specific expenditures. In some countries, the legislator must show where will money be found to finance the newfound enthusiasm embedded in the new expenditure

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Budgets are also influenced by exogenic factors, not controlled by the government. Force Majeure cases, like the floods in the Czech Republic (3 billion USD) and in Poland (2 billion USD). Geopolitical processes like wars and peace agreements in the Middle East (the 1979 peace cost Israel almost 4 billion USD to implement). The onerous, depressingly uniform demands of the IMF from poor countries: austerity, fiscal tightening, a monetary squeeze, privatization, deregulation and so on.

Some countries are voluntarily subject to externalities: the EU countries agreed to amend their budget in order to comply with the Maastricht criteria. The French and German Premiers appointed special committees to review the budget. The reports submitted by these committees forced the governments to cut spending, increase taxes and tighten the fiscal discipline (never mind that the French committee failed to take into account the renaissance of the French economy and greatly exaggerated the projected budget deficit). In all these cases an act of rebalancing the budget is called for.

The USA has a peculiar budgetary procedure. Its Federal budget is made up of 13 separate bills. They are submitted to Congress for approval by the administration. When the President and Congress disagree, some of the bills are not approved and certain government operations are shut down. This happened in the 1996 fiscal year. In fact, the budget for fiscal year 1996 has been approved only after the 1997 budget was.

In the case of such a deadlock, stop gap budgets are passed by Congress to allow the government to continue to function until a final budget is positively voted on.

Budget are acts of humans. They represent hard data implausibly coupled with aspirations, projections, goals and hopes. They are prone to mistakes, greed, cronyism, ulterior motives. The existence of a mechanism to amend budgets is, therefore, of the essence and to be greeted. A budget amendment is often ceased upon by the opposition as proof of the government's fallibility and failure. But in a changing world - they who do not adapt through change are doomed. Governments that amend their budgets midway merely admit that they are made of humans and are doing their nation a service.

Sam Vaknin is the author of "Malignant Self Love - Narcissism Revisited" and "After the Rain - How the West Lost the East". He is a columnist in "Central Europe Review", United Press International (UPI) and ebookweb.org and the editor of mental health and Central East Europe categories in The Open Directory, Suite101 and searcheurope.com. Until recently, he served as the Economic Advisor to the Government of Macedonia.
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Budget is NOT a four-letter word! by Kathy Gulrich

Okay, here goes. Just about everything you'll ever need to know about budget, right here, in three sentences:

Start with all the money you have coming in (your job, selling your work, your rich uncle, etc.). Subtract all the money going out (art supplies, car payments, mac and cheese, etc.). What's left is your profit.

If your profit is enough to live on, fabulous! Skip right to next month's article....

If your profit covers all your art costs (canvas, paper, paints, classes, etc.), congratulations! You're breaking even.

If your profit is ... uh ... a NEGATIVE number ... you've got a bit of work to do. But it IS pretty simple. And I'll show you exactly what to do.

But first, let me give you a little incentive to follow through. Here are seven ways a budget can help you become a better artist - AND sell more artwork:

1 - YOU'LL BE MORE FOCUSED ON YOUR ART. If your attention is on how much money you need - or how much money you don't have - it's not on your art. So do a budget. You'll see right away how to improve your financial situation. And that'll give you much more free attention for your art.

2 - YOU'LL HAVE THE TOOLS TO CONTINUE WITH YOUR ART AS LONG AS YOU LIKE. If you're spending more than you're earning, it won't be long before you run out of money to pay for your art. A budget will show you changes you can make - NOW - so that you'll be able to support your art in the future.

3 - YOU'LL VALUE YOUR WORK EVEN MORE. The price you put on your artwork defines your income (the money coming IN from your art). Understanding your budget will help you price your work in a way that'll support you as an artist.

4 - YOU'LL NEVER DISCOUNT YOUR WORK. There are lots of reasons that you should never discount your work. Your budget is yet another! Once you see how important every dollar is to your profit, it'll help you stick to your prices - no matter how persistently someone haggles with you. (To learn more about why you should never discount your work, check out the article "How much? You decide," here.)

5 - YOU'LL IMPRESS YOUR BUYERS AND COLLECTORS. When you have a budget (the basis of your art business plan), you'll be more professional. And that's pretty impressive to collectors! Just see how your sales increase once you start handling your

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art career as a business, rather than a hobby.

6 - YOU'LL HAVE A MUCH NEATER STUDIO. I know this sounds like a stretch. But it's true! Here's why: First, you'll think long and hard before you run out and buy a bunch of new paints ... or that cool neon paper ... or anything else that you don't really need.

But that's just the half of it. You'll take a good look around to see what you already have ... BEFORE you head to the art supply store. The result? More money in your pocket, and less stuff to find room for in your studio!

7 - YOU'LL BE MORE REAL - WITH YOUR ART, WITH YOUR LIFE. Let's face it, totally ignoring your financial situation doesn't do anything for your art. And it sure doesn't make things easy for people around you. So come on, just do it!

It's not really that hard (I promise...).

Most people are pretty good at the 'money coming in' part, so I won't say much about that. All you need to do is keep track of how much money you earn each month (job, gifts, artwork sales, etc.).

I'm willing to bet, though, that you're NOT very accurate about how much you spend. So here's the plan:

Starting today - and for at least four weeks, every day - write down every penny you spend. Yep, EVERY penny. From your morning newspaper, to your new canvas, to the new pair of sandals you just couldn't live without. (It may help to buy a small spiral notebook for this. And yes, the price of the notebook gets written down, too!)

Also, every time you get a bill (telephone, rent, etc.) over the next month, save it.

Pretty easy so far, right?

Here comes the interesting part. At the end of the month, take a look at some of the 'small' things you're spending money on.

Say, that $1 cappuccino you have every morning to get you going. Couldn't you go a lot further on the $365 you'd save - every year - if you had coffee at home instead? (Hmmm. Three cappuccino-less years and you could save, let's see, more than a thousand dollars....)

Take a look at all the places you could save - WITHOUT having to change your lifestyle. For example, magazine subscriptions for magazines you don't have time to read. Framing that you usually send out, that you could easily do yourself. A cell phone plan with way more minutes than you ever use. Get the picture?

Just thinking about how you're spending will help you spend less. Guaranteed. So go for it! In fact, have fun with it!

And maybe one day soon I'll bump into you at some fabulous little restaurant that costs about half as much as the one we used to go to!

Award-winning New York City artist Kathy Gulrich specialized in helping other artists be successful, too. Sign up for her FREE smART business e-newsletter for artists at: http://www.smARTbusinessCoaching.com/newsletter_html

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