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# PROBLEMS OF STATE DEBT MANAGEMENT IN GEORGIA

## Abstract:

One of the topical problems of modernity is the investigation of the reasons, which had caused origin of the state debt, its assessment criteria and indicators. The article has investigated reasons causing both the permanent growth of domestic and external debts of developing and post socialist countries and their debt crisis. The article analyzes economic, social and political developments resulting the permanent growth of domestic and external debt in developing and post socialist countries.

There are set out conclusions for regulation of financial, foreign exchange, foreign and trade relations. The article suggests concrete efforts aimed to overcome debt crisis. For this reason we suggest to use universal recognized methods and mechanisms, which will support to overcome the debt crisis.

## Keywords:

State Domestic Debt, State External Debt, State Debt Management, Debt Crisis, Debt Burden.

**JEL Classification:** F34, H63, H79

## Introduction

Country executing its functions often is founded in the situation, when the own financial amounts are not enough to implement the aims and tasks set. In such conditions the state faces the need to attract the internal and external loan to fund the budget costs and cover the budget deficit. Such attracted debt causes the emergence and increase of state debt. Coming out of the mentioned, the rapid growth of state debt under the modern market economy conditions became the main problem of many countries of the world. State debt actually increases in all countries, the reason of which is the deficit budget and increased negative balance of the balance of payment of the country.

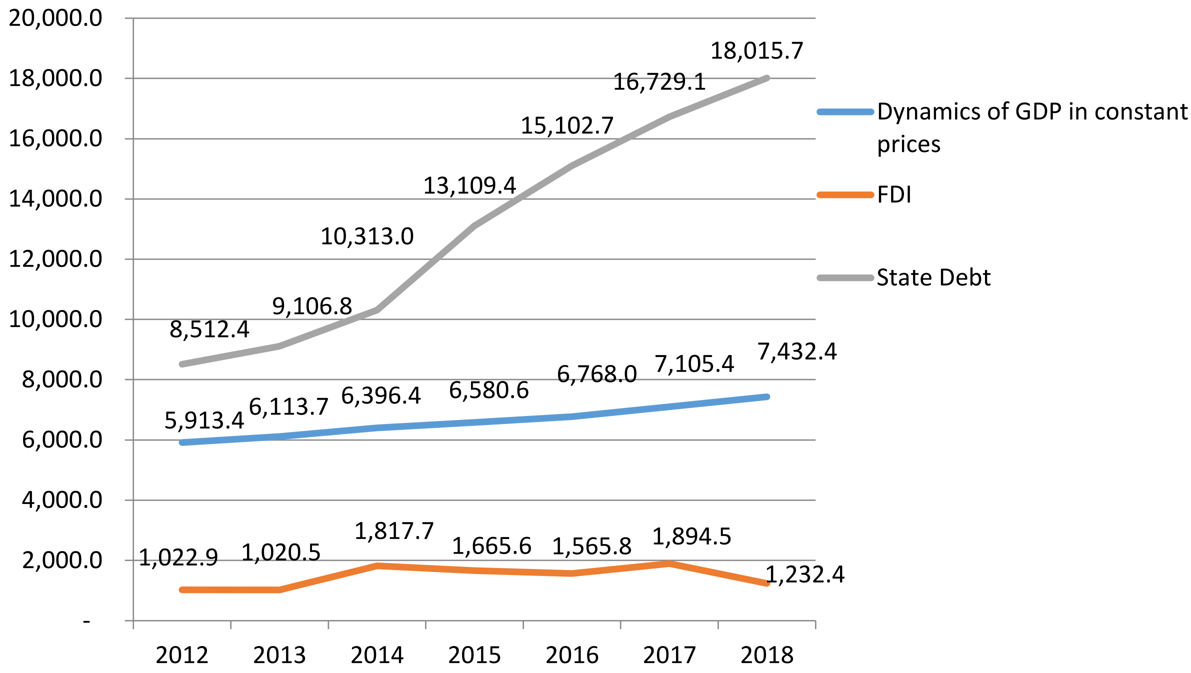
Coming out of the above mentioned, the significant meaning in solving the state financial policy issues possessing tactical and strategic character at their maximum efficiency is given the state debt management and regulation issues, also the working out the efficient mechanism managing the internal and external liabilities. As in developing and post-soviet countries, often there is no possibility to timely use (apply) the flexible methods of debt service and management.

As a rule, the main aim to manage the external liability is to gain the benefit from the foreign funding, ensure the macroeconomic stability and maintain the country`s solvency. The reach of these aims need the investments, economic growth and analyzes the interconnections between the external loans. In order to service and manage the internal debt it is necessary to work out and improve the proper legislative and methodic documents.

## State debt analysis for the case of Georgia

One of the main long-term priorities of Georgia is to reach the sustainable development and high rates of economy`s increase. Coming out of the mentioned, the important attention is drawn to the state debt`s reasonable management. As the external credit and investments funded by it will turn into increasing factors only if the actual cooperation between the financial sector and the economy exist, from another side if the short-term financial flows (with speculative character) will gradually transform in long-term manufacturing investments. As we see from the schedule, according to 2009-2018 years data, GDP`s actual rate annually increases compared to its indicators for the past year and in average this increase equals to 4.7 percent. It should be noted, that economic increase rates of 2017-2018 years essentially excess the similar data for 2016 and 2015 years (accordingly by 2.85 and 2.88 percent), that indicates in GDP`s increasing tendency.

**Figure 1: Dynamics of GDP in Constant Prices, FDI, State Debt (mln. Gel)**




*Source: Ministry of Finance of Georgia, National Statistics Office of Georgia (GeoStat) and calculations of authors*

The problem regarding the external liability in Georgia raised in order to overcame the economic problems occurred after the dissolution of Soviet Union

The decision, about what type of state debt portfolio should have the developing or post-soviet country is up to current country`s economic condition. The countries with low income have available foreign credits with relief percentage rate and long term. Thus, notwithstanding the fact, that state obligation possess the currency risk, it presents more cheaply funding source comparing to domestic liabilities. The long-term external credit with relief terms is more secure, than taking the domestic liabilities, which are mainly short-term and face the refunding risks. The practical experience of the countries with transitional economy proves, that it is necessary to analyze the internal and external debts (by foreseeing all possible risks, expenses and external effects) during the definition of optimal state debt portfolio (Aslamazishvili, 2018).

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**Table 1: Total Budget Balance**

| | Total budget balance (mln.GEL) | Total budget balance (GDP %) | BOperating Budget Balance (GDP %) | State debt (mln. GEL) | | | |
|---|---|---|---|---|---|---|---|
| | | | | Domestic debt** | Foreign debt** | State debt** | State debt (GDP %) |
| 2012 | -154.7 | 19.4 | 0.6 | 1895.2 | 6617.2 | 8512.4 | 32.5 |
| 2013 | -303.7 | 38.6 | 1.1 | 2016.9 | 7089.9 | 9106.8 | 33.9 |
| 2014 | -579.5 | 65.6 | 2 | 2570.5 | 7742.6 | 10313 | 35.4 |
| 2015 | -341 | 35.3 | 1.1 | 2827.3 | 10282.1 | 13109.4 | 41.3 |
| 2016 | -479.4 | 45.6 | 6.5 | 3170.6 | 11932.1 | 15102.7 | 44.4 |
| 2017 | -324.1 | 28.2 | -0.9 | 3535.2 | 13193.9 | 16729.1 | 49.2 |
| 2018 * | -323.2 | 0.8 | 5.4 | 3922.5 | 14093.2 | 18015.7 | 48.3 |

*Source: Treasury of the Ministry of Finance of Georgia, National Statistics Office of Georgia (GeoStat)*
*Note: * Preliminary data*
*** End of period*

As we see from the table, during 2012-2018 years, Georgia`s budget`s total balance was significantly (5.7-times) worsened. During the mentioned period, the state debt was increased by 9503.3 million Lari, which was mainly stipulated by 2.1-times increased external debt.

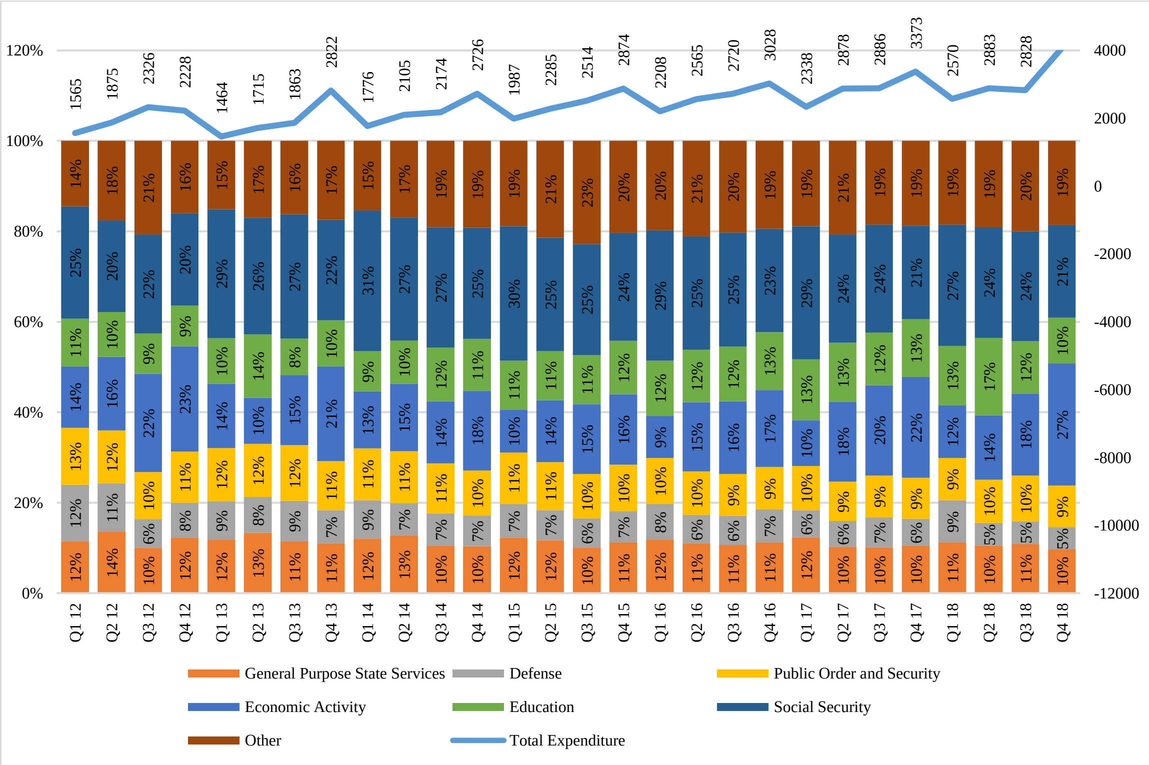
Under the years of the analysis the state debt was presented by 81.7 percent of external debt and 18.3 percent of domestic debt. The main part of external debt (in average 78 percent) was associated with multilateral creditors and the rest (in average 22 percent) with – bilateral creditors.

The state debt`s service costs in 2012-2018 years was 2,544 million USD. From this amount, about 1,930.7 million USD was directed to cover the main (principal) amount. Under the mentioned years, the increase of Georgia`s state internal debt (in average by 22 percent).

As a rule, the indicators (percentage relationship with state debt`s budget incomes, export and GDP) used for the definition of state debt`s value are expressed in limiting indicators and finally, all three of them characterize the country`s fiscal condition. Besides, it should be noted, that most important of these factors is the relationship of state debt with nominal GDP, which (according to parameters established by international monetary fund) shouldn`t exceed 60 percent of ratio of state debt and GDP for the developed countries and 40-50 percent of ratio of state debt and GDP for the developing countries in order to maintain the state debt`s sustainability. As we see from the schedule, according to the mentioned indicator, the state debt of Georgia doesn`t exceed the defined limit, accordingly in 2012-2018 years, on the background of 15.8 percent increase in Georgia, it was defined by 48.3 percent (see the Figure 2).

As we can see from the figure, the volume of Georgia`s state external debt is increased year by year, the increase of GDP is significantly backward from it. It should be foreseen, that together with increase of the main debt, its service costs increase as well.

**Figure 2: Quarterly dynamics and structure of budget expenditures 2012-2018 (mil. Gel)**



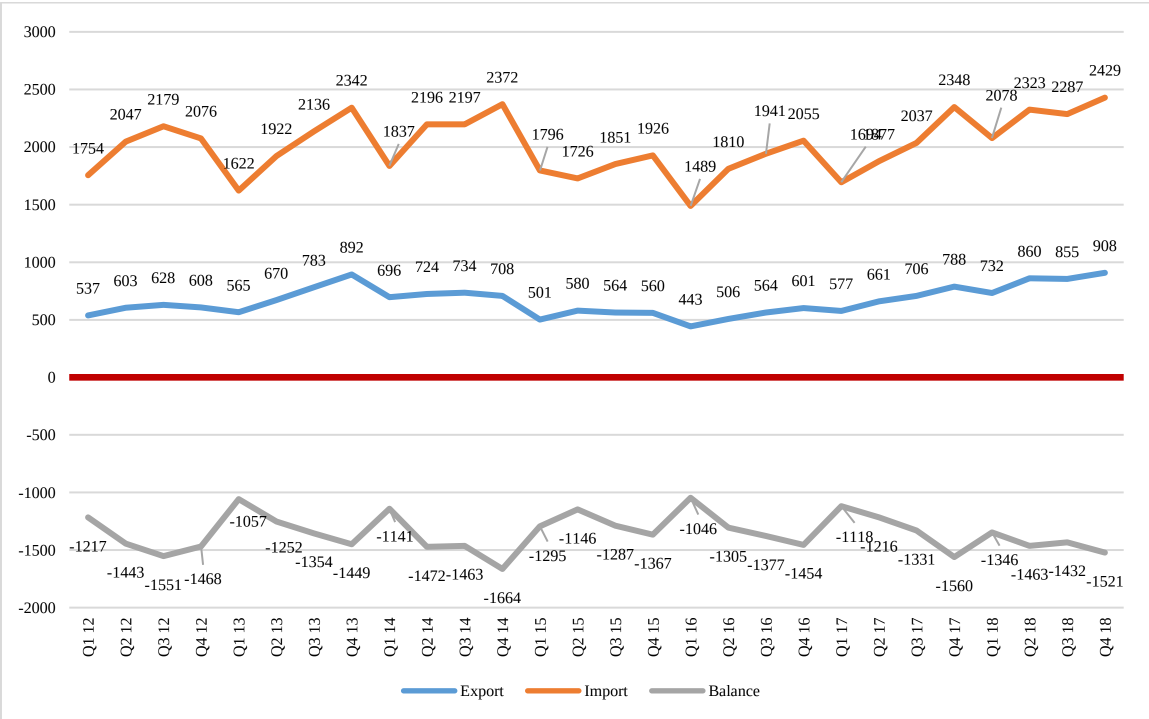

*Source: Ministry of Finance of Georgia, National Statistics Office of Georgia (GeoStat) and calculations of authors*

During the analysis of the condition regarding the state external debts of the developing countries, as one of the key component is deemed the deficit of the balance of payments.

In order to ensure the economy`s stable condition, it is necessary to work out the flexible strategy to manage the debt by country`s government. In particular, under the macroeconomic scope of view, the government should ensure the receipt of state external debt in an amount, which will guarantee the debt`s service by foreseeing the wide spectrum risks. Because the country might be put into unfavorable condition as a result of incorrect definition and assessment of the period covering an external debt, interest rate, adjustment of debt`s currency and issues regarding the regulation of debt`s burden (Bakhtadze, Danelia, 2017).

It is optimal to foresee the export potential while comparing to the other countries, as an export potential is more precise indicator during the debt`s load assessment. Unfortunately, the supremacy, Georgia has comparing to the other countries (in the scope of relation between an external debt with GDP), is absolutely cancelled by indicator of ratio of the debt with export, that is caused by quite low level of productivity in the country and is evidenced by statistical data regarding the total export of Georgia brought down (BAKHTADZE, 2006).

**Figure 3: Quarterly dynamics of total imports, exports and trade balance (mln. USD)**




*Source: National Statistics Office of Georgia (GeoStat) and calculations of authors*

From the Figure we can find out, that during the mentioned period 2012-2018 years (see Figure 3).

Coming out of the condition existing in the country, it is justified to take an external debt to fund an infrastructural project, which will additionally stimulate the economy. Accordingly, the increasing dynamics of the taxes taken out of increased employment and infrastructural projects will be positively reflected on the increase of state budget incomes.

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In order to ensure the efficient management of the debt, it is quite important to define the liability covering terms. Despite the fact, that 80 percent of the liabilities of developing countries carry the relief character, the loan with same amount (volume) might have different load for the country (by foreseeing the percentage rate and debt`s covering terms defined under the agreement).

While projecting the country`s external liability and economic indicators related to it, it is important to take into consideration the debt`s service dynamics by country (see Figure 3 and brief analysis).

The huge importance is given to accumulation of international monetary reserves of the country, which is achieved by interventions of National Bank of the country and via financial supports received by donor countries and international organizations.

As of use of domestic securities to fund the deficit budget, it has numerous supremacies, in particular:

The debt in the national currency decreases the risk associated with currency. The service of domestic debt (comparing to external debt) is not depended to changes in currency rates. The fluctuation of currency rate doesn`t increase the domestic debt`s service costs, which decreases the risk of country`s default at its minimum. Besides, the less dependence on currency rates grants the government the freedom to use the exchange rate, as the stabilization mechanism against the foreign shocks. As a result of which the fiscal influence on the exchange rate policy is decreased (Bakhtadze, 2013).

The risk of capital drain is low, as mainly the residents hold the country`s domestic obligations. It is important to have investors` structural analysis. The extension of investors` group increases the debt portfolio`s diversification quality and encourages the elimination of risk of percentage rates and refund. Though, there are another risks: coming out of the situation, under which, if domestic debt`s instruments are mainly held by commercial banks, then the effect of driving out the investments from private sector is about to increase. Generally, banking field holds the incentive to invest the money in state securities and gain the profit by crediting the public sector. This might cause the decrease in the funding of risky private sector, which weakens the efficiency of banking operations and the role of bank – as the mediator. The effect of investment`s driving out is especially dangerous for the countries with low income, as small and medium sized companies are quite depended on the bank`s funding (Bakhtadze, Kakulia, 2013).

During the deficit budget conditions, the debt`s burden forces the country to take out big amounts of liquid means from the market. As a result, the impact on percentage rates and currency rate is increased and the investment activity is decreased. This leads to the break of balanced economy. If the government fails to take the debt from creditors, it is only left with chance to apply the National Bank of the country, which means the inflation with its destructive result, or decrease of monetary reserves and in the worst case – both of them together (Chikviladze, 2018).

It should be noted, that notwithstanding some of indicator`s popularity, it has some defects as well. For example: during the relationship of existing external debt and the export, it should be foreseen, that countries using those amount for long-term investments, will have a bad condition (according to this indicator) on the starting stage, though, later they will significantly improve their condition (Zubiashvili T, Chikviladze M, Silagadze, 2018).

The state debt`s managing strategy has a direct connection with macroeconomic and financial policy of the country. As a whole, the main aim of state debt`s managing policy is to give the country economic and financial benefit from external and domestic funding in a manner, that avoids the macroeconomic issues and maintains the stability of the balance of payments. In order to avoid the state debt`s negative impact on the economy, debt`s management should become the permanent part of macroeconomic policy. Many country commences their debt`s management during the crisis, which might be too late, as its management process implies to avoid exactly this crisis situation.

## Conclusion

To conclude, we can say that the rapid growth of state debt under the modern market economy conditions became the main problem of many countries of the world. The significant meaning in solving the state financial policy issues possessing tactical and strategic character at their maximum efficiency is given the state debt management and regulation issues, also the working out the efficient mechanism managing the internal and external liabilities. As the external credit and investments funded by it will turn into increasing factors only if the actual cooperation between the financial sector and the economy exist, from another side if the short-term financial flows will gradually transform in long-term manufacturing investments.

In order to ensure the economy`s stable condition, it is necessary to work out the flexible strategy to manage the debt by country`s government. In particular, under the macroeconomic scope of view, the government should ensure the receipt of state external debt in an amount, which will guarantee the debt`s service by foreseeing the wide spectrum risks. Because the country might be put into unfavorable condition as a result of incorrect definition and assessment of the period covering an external debt, interest rate, adjustment of debt`s currency and issues regarding the regulation of debt`s burden

Finally, coming out of the condition existing in the country, it is justified to take an external debt to fund an infrastructural project, which will additionally stimulate the economy. Accordingly, the increasing dynamics of the taxes taken out of increased employment and infrastructural projects will be positively reflected on the increase of state budget incomes.

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