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Foreign Debt and Its Reduction Strategies (Example of Developed Countries)

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Abstract

In an era marked by persistent threats and escalating global instability, effective government debt management has emerged as a paramount concern for nations worldwide. The aftermath of the financial crisis witnessed a substantial surge in public debt across numerous countries, igniting fervent discourse within academic realms regarding optimal debt management strategies. Amid this backdrop, the urgency to identify and implement the most efficacious methods and tools for managing public debt has intensified. Countries across the globe are diligently scrutinizing various approaches to navigate the complexities of public debt management. This entails a meticulous evaluation of diverse mechanisms and instruments aimed at mitigating the risks associated with burgeoning debt levels. The imperative to strike a delicate balance between fiscal prudence and economic stimulation underscores the gravity of this endeavor. The discourse surrounding public debt management underscores its multifaceted nature, necessitating a nuanced understanding of economic dynamics, policy frameworks, and global trends. From debt restructuring and refinancing initiatives to the utilization of innovative financial instruments, nations are exploring a myriad of avenues to alleviate the burden of public debt while fostering sustainable economic growth. Moreover, the imperative to foster international cooperation and coordination in debt management efforts looms large, underscoring the interconnectedness of global economies. Collaborative endeavors aimed at enhancing transparency, bolstering debt sustainability frameworks, and fortifying institutional capacities constitute pivotal components of a comprehensive approach to public debt management in contemporary times. As nations navigate the intricate terrain of public debt management amidst an increasingly volatile global landscape, the imperative to adopt prudent, forward-thinking strategies remains paramount. Through concerted efforts and informed decision-making, countries can chart a course towards fiscal resilience and economic prosperity in the face of mounting debt challenges.

Keywords: *Government Debt; Domestic Debt; Foreign Debt; Debt Reduction*

Introduction

Government debt is the amount of budget deficit accumulated over a certain period of time (the excess of expenditures over revenues). In other words, it is the amount of debt the government owes to holders of government securities. The main reason for the formation of public debt is the budget deficit.

The presence of free funds of individuals and legal entities allows the state to unite the interests of lenders and borrowers.

Government debt is a pressing problem that every country faces from time to time, to varying degrees of severity.

Methods, Results and Discussion

In subsequent years, the problem of external debt became global. The stability of servicing the state's external debt is one of the main factors of macroeconomic stability in the country. The lack of a consistent government policy to attract and use external financial resources leads to an increase in external debt, which is a serious obstacle to economic development. changes [1]

Government debt is the result of financial borrowing by the government to cover budget deficits and government guarantees for the debts of private and public companies. The national debt is equal to the sum of the deficit of previous years, taking into account the deduction of the budget surplus.[2]

When considering public debt, as a rule, the claims of this state against others are not taken into account, that is, the debt of other states or individuals and legal entities to this state is not taken into account.[3] The state's obligations in the field of social and pension security are also not taken into account.

The amount of public debt is expressed in national currency or its equivalent in any other currency.[4] To compare debt levels across countries, the ratio of government debt to gross domestic product (GDP) is often compared.

The Budget Code provides a legal definition of this concept as the amount of debt obligations to legal entities and individuals, foreign states, international organizations and other subjects of international law.[2]

The main reason for the formation of public debt is the state budget deficit.[5][6] An increase in public debt affects the state of the economy as follows:

1. Redistribution of internal income. Paying interest on government debt increases income inequality because much of the government debt is concentrated among the wealthiest segments of the population, increasing income inequality.
2. Increasing taxes (as a means of paying off domestic debt, as well as reducing it) reduces the population’s interest in investing in risky projects, weakens the effect of economic stimulation of production development and, consequently, increases social tension.
3. Crowding out of private investment as a result of rising interest rates on capital.
4. An increase in interest rates in the domestic market leads to an increase in demand for government securities from foreigners, which, in turn, increases external debt.

There are two types of debt: internal and external. Internal - the state's debt to its residents, that is, enterprises and citizens who own securities issued by the state. To reduce it, it is necessary: to maintain the rate of economic growth above the rate of growth of public debt; an increase in the fiscal burden, and a reduction in government spending, that is, a reduction in the budget deficit.

External debt is debt owed to foreign countries, organizations, or individuals. This is, first of all, debt on government securities, as well as loans provided to the state by external creditors, the debt of budgetary organizations for foreign trade operations.

External debt is dangerous for the national economy because it implies the need to provide valuable goods and services to repay the debt itself and the interest on it.

In world practice, the following mechanisms for reducing external debt have developed:

1. Debt repurchase is an opportunity for the debtor state to purchase debt obligations on the secondary securities market at a lower price.
2. An exchange of debt for shares (swap) involves providing foreign banks with the opportunity to exchange the country's debt obligations for shares of industrial corporations. In this case, foreign capital receives a share in the capital of other countries, and external debt is reduced.
3. Replacement of existing debt obligations with new ones, possibly with a lower interest rate.

Official creditors (members of the Paris Club) enjoy the following benefits, in addition to the basic ones, for the poorest debtor countries: partial debt write-off, reduction in interest rates on debt service, and extension of the term of debt obligations.

Public debt is also divided into current and capital. Government debt capital is the sum of the government's outstanding and issued debt obligations, including accrued interest payable on those obligations. Current public debt is the government's expenditure on repaying creditors and paying off outstanding obligations. [7]

External debts of the state to a certain extent increase resources for economic development, but at the same time require their servicing (payment of principal and interest). When determining the monetary and financial terms of an international loan, the lender takes into account creditworthiness (the borrower's ability to obtain a loan) and solvency (the borrower's ability to repay its obligations in a timely manner and in full). A sign of an approaching solvency crisis is a violation of the payment schedule for servicing the government's external debt.

To determine the real economic situation of the country, relative values are used, in particular, the ratio of public external debt to GDP. The size of government debt relative to gross domestic product is an important indicator of a country's economy. Financial relations associated with the formation and servicing of public debt have a positive and negative impact on the state of public finances, the country's investment environment, consumption structure, development of international cooperation, and many other elements of the country's socio-economic life. can show. Public debt plays a multifaceted role in the further development of the country. This has a positive and negative impact on the socio-economic processes taking place in the country.

The following risks may cause high levels of external public debt:

1) The risk of refinancing if it is impossible to repay the debt at a price acceptable to the debtor country, which could lead to a financial crisis or serious economic losses;
2) Liquidity risk - a broader definition of refinancing risk, including problems of mismatch between assets and liabilities;
3) Market risks, that is, currency, interest, etc., which lead to changes in interest rates and exchange rates;
4) Credit risk - losses associated with failure to fulfill obligations to the borrower. [1]

In international practice, there are several ways to reduce debt in the public sector, taking into account the interests of creditors in different ways. Maintaining economic growth rates that exceed the growth rate of government debt is most beneficial for creditors and takes into account the interests of all stakeholders. However, this method is very long-term and requires not only maintaining a low cost of capital, but also maximum employment, full utilization of production capacity, increasing labor productivity, developing fundamentally new technologies, etc. Of course, countries with serious debt problems cannot go according to this scenario.

Increasing the financial burden and reducing state budget expenditures is the next most obvious way to reduce debt, taking into account the interests of creditors, but limiting the interests of budget recipients. This method is already used by many countries with high debt burdens, but it is not yet intensive enough to address the problem of accumulated debt and fiscal imbalances. The downside is a pause in economic growth and a possible worsening of the global business cycle. Overall, this explains the cautious approach taken by central governments in using this method.

The third option lies in the area of monetary policy and involves maintaining negative real interest rates or other debt inflation over the long term. This method has been used with varying degrees of success in many developed countries over the past few years and, in principle, appears to be conditionally acceptable for creditors, and is also very convenient for the state. However, the downside is the risk of inflating bubbles in financial asset markets in an environment of overly loose monetary policy.[8]

Conclusion

In recent decades, high- and middle-income countries have taken significant steps to improve the efficiency of public debt management and significantly improve the composition of debt portfolios. Most of these countries have begun to use modern methods for forecasting debt dynamics and servicing costs, as well as improved methods for assessing debt risk, taking into account the development factors of the recent financial crises. Other trends in the field of regulating external public debt include adjusting the objectives of debt management and changing its organizational and administrative system. In addition, improving the accounting for contingent liabilities has become a special focus in this area. [9]

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