Debt–to-GDP Ratio and the rate of indebtedness of the Republic of Macedonia

Abstract

Even after a long usage, the indicator Debt-to-GDP ratio of the public debt has been arousing opposing views in terms of its importance in assessing the rate of indebtedness of a particular country or groups of countries. Hesitations are being caused by cases in which countries with lower Debt-to-GDP ratio run into debt crisis whereas those with higher Debt-to-GDP ratio have no problem with discharging the public debts.

At the end of 2012, the indicator signifying the ratio of the public debt to GDP in the Republic of Macedonia stood at 30%. The announcement that the Government plans to get into debt of new 300 million euros, has caused 'a storm' at the Parliament upon handing down the budget of 2013. The Government defended the move to indebtedness, pointing out that the above mentioned per cent turns the country to low-indebted countries and according to this, it has a margin for new debts whereas the Opposition has objected to this asserting that such a move leads the country into reaching a debt crisis. There have arisen diametrically opposing views on the same fact.

In this supplement, we would deal with the importance of Debt-to-GDP ratio; we would explain why countries with very high Debt-to-GDP ratio have less problems with the servicing of public debt than countries with low Debt-to-GDP ratio and in that context, we would deal with the ratio of indebtedness of the Republic of Macedonia.

Key words: Debt-to-GDP ratio, public debt, Gross External Debt, rate of indebtedness, ability to service obligations.

Introduction

Although it has always been important how much the Government may incur debts and for what purposes, in order to be able to service the obligations promptly, the use of Debt-to-GDP ratio has acquired a meaning of criterion (upper limit), which must not be passed, as a condition for joining the countries – members of the Union in a zone with unique currency i.e. in the euro zone. The frequency of the use of the indicator Debt-to-GDP ratio has increased the last few years, during the biggest financial and economic crisis after the II World War, especially after the debt crisis in the euro zone and in the developed capitalistic countries.

From the numerous reviews of the countries according to the Debt-to-GDP ratio, it clearly flows that there is no point of determining any percentage as a unique criterion for separate groups of countries, especially for those at a different level of development and at a global level. Processes can be conducted, but they don't have any sense and cannot serve for drawing conclusions about the rate of indebtedness of a particular country in relation to another one according to their Debt-to-GDP ratio. Greece, with a lower Debt-to-GDP ratio, has got into a difficult debt crisis, whereas Japan with a higher one, still has no problems with the servicing of obligations. Or, France and Germany have approximately the same Debt-to-GDP ratio, but the burden of the public debt can be felt more in France than in Germany. The USA have already registered public debt in the amount of 100 % of GDP, but, objectively, there should be no problems with the servicing of obligations, if the political conflicts, in reference to the determination of a new limit of getting the country into debt, are surpassed.

The fact that the Debt-to-GDP ratio cannot be determined as a unique criterion according to which the countries will be compared in terms of the rate of their indebtedness, does not mean that the Debt-to-GDP ratio has no importance in assessing the rate of indebtedness of separate countries within a fixed period. The Debt-to-GDP ratio is an indicator of the economy's "health". The public Debt-to-GDP ratio reflects the "health" of governmental finances, whereas the total Debt-to-GDP ratio reflects the "health" of the entire economy, and not in relation to other countries, but in reference to the factual capabilities of the country to service the obligations towards abroad in due time. They depend on:

-whether the debts are discharged by one's own currency as it is a case of countries whose currencies are kept as currency reserves by other countries,

-what is the relation between the debt within the national currency and the debt within the foreign currencies like,

-what is the feedback between the debt and the growth like, especially the one between the debt and the growth of currency inflows, because the more rapid growth of debt, leads to its increasing and to worsening the opportunities of discharging it,

-under what conditions, the borrowings are taken out (interest rate, conditions - terms, grace periods),

-whether the country is a member of the Monetary Union in which there is solidarity in surpassing certain problems, including the debt crises.

There can also be listed other conditions that result from the specifics of separate countries, but they are significant for assessing the rate of their indebtedness.

The Debt-to-GDP ratio shows the state of debt towards GDP

In the listed conditions can also be recognized individual characteristics of separate countries, but they are also general characteristics in that respect that they represent an advantage or weakness for separate countries.

The countries whose currencies are kept as currency reserves by other countries (the USA, the Euro Zone, Japan, Great Britain) theoretically, have limitless possibilities to accumulate debts, but practically, they also have to pay attention to keep the trust of their creditors. If the trust is endangered, especially because of decreasing the value of reserve currencies, the foreigners will cease to finance the debts of the countries whose currencies are falling at a faster pace than those of some other countries. In such a case, it is probable that the creditors will start to free themselves from the governmental bonds more intensively, and will cause undesirable consequences at the bonds' market. Therefore, they can accumulate debts considerably more than the other countries, but not as many as they want, if they don't like to take a risk of trust crisis in their own currency, as a result of what, they would lose the privileges which arise from the fact that their national currency performs the function of a global one. The large differences in the height of the Debt-to-GDP ratio between separate countries are due to the fact whether the debt of a particular country is more in national currency than in foreign currencies. Considering the servicing, the countries whose debts are denominated in a national currency, are in more favourable situation. In order to repay the obligations in one's own currency, there can be printed suitable amounts of national money, whereas in order to discharge the obligations in foreign currencies, it is necessary to perform economic activities that will generate into satisfying the currency inflow. However, this does not mean that each government may increase the debt in national currency without limits. Governments are restricted in their wishes by the assessment of home investors about the profitability of buying state bonds and the trust in making the anticipated profit. If the exaggerated state indebtedness in national currency causes inflation within the country, the trust and interest in state bonds reduce, and as a result of this, the possibilities for further indebtedness in home currency are reducing too.

Quite a suggestive example is the situation in Japan. It has a rate of indebtedness that exceeds even 200 % of GDP, but, it has no problems with the payment of state debts that arrive to be paid. " The door-handle ", among the other things, shows that the main part of its debts is in yen (home indebtedness – 94 % of Japan bonds are kept by investors within the country's frames), and not in foreign currencies, for whose payment, it should be earned through export of goods and services. However, there is no doubtfulness that the growth of home indebtedness is based upon the successful economic relations between the country and abroad. Japan still has surplus balance out of its exchange with foreign countries (trading and capital), so that it can service the debts towards abroad on time. However, for the sake of truth, it should be said that the high public debt starts to worry the Japanese, given the fact that the last year the country marked the first trading deficit after 1980, whereas the budget deficit continues to increase itself. In the last five years, the surplus in the current account reduced of almost 6 % of GDP in 2007 to only 1 % nowadays. By decreasing the level of household saving and with chances of new fiscal deficit, the current account will be negative soon, forcing Japan to sell its debts to foreign purchasers.[1]

[1] Feldstein: The Wrong Growth Strategy for Japan, project Syndicate, Jan. 17, 2013, http://www.project-syndicate.org/commentary/the-wrong-growth-strategy-for-japan-by-martin-feldstein

It is clear that the repayment of debt can also be made by printing yen, but that brings into question the stability of the economy and national currency. Among the other things, and of course, thereby, the rating agency Moody’s has reduced the long-term rating of the state debt of the country.

Of main importance in the assessment of the particular country's indebtedness rate, is the feedback between the debt and the economic growth, especially between the debt growth and the growth of currency inflows. This opens two questions: about the use of funds borrowed by governments[2], and about the origin of the funds. If they are spent for current needs for a longer period, their influence upon the economic growth is unimportant. As a consequence to this, there will be registered worsening of the Debt-to-GDP ratio. If, however, the borrowed funds are used for building productive and infrastructural capacities, they will contribute to the enhancing of economic performance, and the indicator Debt-to-GDP ratio will improve itself.

The feedback between the debt and the growth is quite important even from the aspect of the borrowed funds’ origin. Serious problems arise when the debt, which is provided by abroad, increases constantly, and the growth of currency inflows is slower than the debt growth. Such discrepancy leads to increasing the burden of debts’ discharge, worsening the conditions of indebtedness and decreasing the possibilities of new debts.

In reference to the previous condition, of great importance are also the conditions under which the borrowings are taken out from the foreign countries (interest rate, conditions – terms, grace periods). This is especially important for the less developed countries. They have need of additional accumulation in order to accelerate their growth so that they can reduce the gap in the level of development. If the borrowings are with low interest and longer terms, it means that those countries can show higher absolute amounts of debt, i.e. higher Debt-to-GDP ratio, and at the same time not to endanger the possibility for servicing the obligations.

Out of the listed conditions, it arises that it is impossible to find two countries that would have the same Debt-to-GDP ratio having equal importance in the countries’ rate of indebtedness.

[2] The professor Robert Skidelsky states: „Government deficits incurred on current spending for services or transfers are bad, because they produce no revenue and add to the national debt. Deficits resulting from capital spending, by contrast, are – or can be – good. If wisely administered, such spending produces a revenue stream that services and eventually extinguishes the debt; more importantly, it raises productivity, and thus improves a country’s long-run growth potential.“(http://www.project-syndicate.org/commentary/good-and-bad)

As a result of this, it is rightly to say that even when the ranges for qualifying the rate of indebtedness are determined according to Debt-to-GDP ratio (low, middle, high), the burden of separate countries' indebtedness is not determined. According to Debt-to-GDP ratio, there are only determined groups of countries arbitrarily. The countries with lower Debt-to-GDP ratio cannot count on increasing the indebtedness, only because of their classification into low-indebted countries. Mathematically viewed, such expectations are even justifiable. However, here, mathematics causes misapprehension. The possibility for getting into debt the countries, whose currencies do not perform a reserved function, does not depend on the affiliation in such arbitrarily determined groups. It cannot be talked about the (re-) indebtedness of a country that is out of the euro zone, by comparing the contracted upper limits of the budget deficit and of the state members' public debt. The things, which apply to the state members, do not apply to the countries, which are out of the euro zone. They cannot count on the benefits that the state members obtain by the functioning of the unique market and monetary system. They cannot count on solidarity when consolidating the actual debt crisis into which they could fall, as it happened to several countries in the euro zone several years ago. The main part of the burden of discharging debts, however, falls to the country - debtor, besides such support. That means that there are not unlimited the possibilities as well, and their upper limit cannot be a benchmark of the possibilities for getting into debt the countries out of the euro zone.

There can also be listed other conditions that arise from the specifications of separate countries, but they are important for assessing only the rate of their indebtedness (structural problems within the economy, qualification of labour power, the level of democracy in the society etc.). For small and insufficiently developed countries such as the Republic of Macedonia, with liberalized capital account, the assessment of indebtedness rate, besides the Debt-to-GDP ratio of the public debt, should include the Debt-to-GDP ratio of the Gross External Debt.

The upper limit of indebtedness determines the ability of financing the mature obligations

It is obvious that the analyses of comparing the height of Debt-to-GDP ratio cannot be a benchmark of Macedonia's upper limit of indebtedness. As a small and insufficiently developed country and out of the larger integrated systems, its upper limit of indebtedness determines its economic and financial ability of servicing the mature obligations towards abroad in due time. For now, with indebtedness rate of 30 % of the GDP, the public debt does not manifest itself as a specific problem. The country succeeds to service it promptly. However, there are indications that the state of indebtedness towards abroad is worsening. At the same time, the deficit in the budget has been increasing constantly for several years, and from -0.5% of GDP in 2006, it fetched -3.5% of GDP in 2012. The same is predicted for 2013 as well.

The last five years, the debt of the country has grown with faster pace than the growth of GDP. The economic growth and its maintenance are becoming dependent upon the growth of the debts, and they cannot increase themselves infinitely if there are not generated conditions for their servicing out of the GDP's growth. This trend shows that the borrowed funds are not used efficiently, i.e. they are not in function of increasing the growth, but they are used, above all, for the current expenditure.

Table 1

Motion of the GDP and the public debt in the Republic of Macedonia in million euros

	2004	2005	2006	2007	2008	2009	2010	2011
Gross Domestic Product	4.442	4.814	5.231	5.965	6.720	6.677	6.944	7.403
Total debt of the central government	1.583	1.648,8	1.673,4	1.430	1.386,7	1.596,9	1.710,6	2.088,8
-External debt	993,2	1.245,4	1.025,2	877,2	921,2	1.105,3	1.173,8	1.582,1
-Internal debt	589,8	603,5	648,2	552,8	465,5	491,7	536,8	506,8
Average export	1.345	1.642,9	1.914	2.472,2	2.692,6	1.920,9	2.492,8	3.036

Source: Ministry of Finance of the Republic of Macedonia, debt of the Central Government (consolidated) to 31.12.2011 inclusive.

From table 1, it can be calculated that during the period from 2007 to 2011, the GDP of the Republic of Macedonia, was increasing by an average rate of 4.4%, whereas the total public debt was increasing by 7.9%, and the external debt by a rate of 12.5%. At the same time, the export was increasing only by 4.2% per year.

Even more direct signal of worsening the state of indebtedness towards abroad is the rapid deficit growth of the current account of the balance of payment. With the continuation of this trend, the conditions for new indebtedness are getting worse, and the possibilities for prompt servicing of obligations towards abroad, are getting endangered. Thus, the possibilities for further indebtedness of achieving more rapid development are getting endangered, as well.

Table 2

Balance of the current account of the balance of payment of the Republic of Macedonia

	2004	2005	2006	2007	2008	2009	2010	2011
Balance	-361,8	-122,5	-23,4	-421,2	-862,2	-457,1	-143,6	-224,3
-net goods	-914,3	-858,5	-1.001,5	-1.181,0	-1.762,5	-1.559,6	-1.447,8	-1.681,8
-net services	-45,6	-29,2	17,4	28,3	9,3	16,5	36,8	98,1
-net income	-30,1	-88,1	-21,2	-280,8	-94,4	-47,3	-99,9	-120,8
-net current transfers	628,2	853,3	981,9	1012,4	985,5	1133,3	1367,3	1480,2

Source: National Bank of the Republic of Macedonia, annual data of Macedonia's balance of payment

Within the analyzed period, the deficit is constantly present in the current account with specific oscillations. That mostly contributes to the growth of deficit in the exchange of goods and the outflow of foreign currencies, above all, on the basis of the transfer of the profit, made in Macedonia. The services are improving the balance of the current account of the balance of payment, except in the first two years when they show deficit. The net current transfers have the most important influence on decreasing the current account deficit. They are in constant growth. The average annual rate of growth is 11.3%. They also cover a large part of the deficit of goods' exchange. In 2005, the surplus in the current transfers covered almost 100% of the deficit in the goods' exchange, and in 2011 – 88%. The inflow is, therefore, decreasing, and it should not be expected the balancing of the current account to rely on the growth of money order of our employees abroad. It is good that, for now, they narrow the gap in the foreign trade exchange.

However, it is bad that it cannot last long. Indeed, till now, no one said that we will export employees so that they can send us foreign currencies to fulfill the import needs, and no one states that Macedonia is a destination that, with an inflow of foreign capital, can provide satisfactory growth dynamics. It is needed a strategy of relying, above all, on its own power, i.e. a strategy into which the export will be a motor of the economic growth and of balancing the foreign relations.

For insufficiently developed country such as the Republic of Macedonia, in conditions of liberalization of the current and capital account of the balance of payments (declared denar's convertibility), it is important the information of the Gross External Debt of the country. The actual non-prompt payment of the mature obligations, on the basis of the public debt, has the same repercussions of the economy as does the non-prompt servicing of the public debt.

Table 3

Motion and structure of the total external debt of the Republic of Macedonia in milion euros

	2004	2005	2006	2007	2008	2009	2010	2011
Gross External Debt of R.M	2.080,2	2.528,2	2.503,4	2.841,1	3.304,2	3.780,4	4.105,7	4.846,6
-public	1.211,4	1.487,9	1.270,4	1.057,4	1.109,9	1.324,9	1.424,3	2.060,2
-private	868,7	1.040,3	1.233,1	1.783,1	2.194,2	2.455,5	2.709,5	2.814,6
Gross External Debt % of GDP	46,8	52,5	47,9	47,6	49,2	56,4	58,2	64,6

Source: National Bank of the Republic of Macedonia, annual report of 2011

From the presented data, it can be seen that the Gross External Debt of the Republic of Macedonia is in constant growth. However, the intensity has been increasing the last several years. In the period 2007 – 2011, the Gross External Debt has been increasing by an average rate of 11.3%, and the public debt by rate of 14.3%.

With the last indebtedness in the foreign countries for financing the budget deficit of the country in 2013, the rate of indebtedness will increase, and if it is not achieved growth of the export and growth of currency inflow, on the other grounds, it is possible further worsening of the possibilities of prompt servicing of the debt, i.e. that will cause a need for new debts. The discrepancy between the dynamics of the public debt's growth and the possibilities of its servicing increases considerably, if it is taken into account the total external debt of Macedonia (both the public and private). With about 5 billion euros, it has already reached the level of 63.3% of the GDP, and according to this indicator, the country's already numbered in the group of "high" indebtedness. This is also indicated in the October quarterly report of the National Bank of the Republic of Macedonia (2012). Given the fact that the information of the low public debt was most often collected from thence, the given information should be reckoned as a warning of the danger to which the Macedonian economy is exposed. The debts of the private sector, ultimately, upon their discharge, shall be borne by the currency inflow, i.e. by the currency reserves of the country. Every debtor has a right to buy an adequate amount of foreign currencies at the currency market in order to cover his obligations. If the offer is less than the demand, as it is going to happen more often because of the growth of the deficit in the current account, there will have to come to interventions by the Central Bank, to decreasing of the currency reserves or to new indebtedness, and in the end, to correction of the value of home currency.

As a consequence of the more intensive growth of debt, the country has already demonstrated practice of indebtedness abroad, because of discharging mature debts by now. That is a situation which cannot last long, particularly, because almost several years the debt has been increasing more rapidly than the growth of the GDP and of the export, i.e. than the possibilities for attaining currency inflow, which will service the discharge of the increased debt. This means that even at the current level of "low" indebtedness, it should be taken into account the dynamics of indebtedness in relation to the possibilities for servicing the debts towards abroad, i.e. the efficiency in the use of the borrowed funds. With the last indebtedness of the country in the amount of 250 million euros from Deutsche Bank, it was paid off the formerly emitted bond of 175 million euros.

The mentioned adverse trends in the growth of the public and total external debt of the Republic of Macedonia, undermine the easiness of the bearers of the macroeconomic policy in the country in relation to the country's indebtedness; not from a view that it should not get into debts further away, but the subsequent indebtedness abroad to be in function of achieving effects that will improve the developing performance of the economy, particularly the currency inflows, and not to satisfy the final expenditure. It should be avoided the shifting of the burden of the public external debt at the expense of the future generations (that should return the debts incurred for more comfortable living and governing).

The listed trends, which suggest worsening of the rate of indebtedness of Macedonia, extort reassessment of the macroeconomic policy. Because the country has an objective need of additional accumulation from abroad in order to accelerate the economic growth, the macroeconomic policy has to avoid the adverse trends threatening with possible difficulties in the servicing of obligations towards abroad. At the same time, of main importance is the change of the monetary strategy of targeting the exchange rate of the denar and the development of export-oriented developing strategy. It is obvious that if nothing changes, the country will face a debt crisis for whose solving, there have to be taken numerous measures (increasing of debts, cutting wages and other income, reducing the number of administrative employees), for which it is said that the country has evaded, as a result of the successful macroeconomic policy, whereas the countries in the euro zone, which incur large debts, apply them. In a more strained situation, it is not even excluded the "naked" devaluation; unless we are prepared for a new developing strategy in which the rate will be determined at a real level and irrespective of the fact whether it is fixed or fluctuating, we will insist to keep it stable.

Conclusion

An identical Debt-to-GDP ratio of the public debt of different countries does not mean an identical rate of indebtedness of the countries, i.e. an identical level of qualifying for servicing the public obligations. The Debt-to-GDP ratio of the public debt only shows the state of the debt to the GDP in a given country. It depends on several factors whether the Debt-to-GDP ratio of the public debt is maintainable or not. In the most favourable situation are the countries whose currencies perform the function of international reserves, but they are not unlimited or without great risks, when borrowing funds from abroad. The other countries, among which the Republic of Macedonia too, have constantly to proportion their upper limit of indebtedness with the economic capacity and to service the mature obligations in due time. That means that it has to be established permanent relation between the dynamics of the economic growth, which depends largely on the commitment of funds from abroad, and the inflow of currency funds, necessary for servicing the total external debt.

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