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Debt Problems in the European Union and Russia: Common Features and Differences

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Abstract: The paper deals with the problems of the indebtedness in the world economy. The evolution of russian public and private debts' problem was described. Risks in debt sphere are analyzed. Common features of Russia and the European Union in debt sphere are detected. They are as follows: worsening of the conditions for borrowing on the international capital market, significant level of corporate debt, contingent liabilities of the budgets, high levels of public spending. Specific Russian features are defined as follows: dependence on world prices for energy resources, low credit ratings, rapid growth of domestic borrowing and quasi-sovereign debt.

Key words: Public debt · Private debt · Public expenditures · Crisis · Contingent obligations · Risks

INTRODUCTION

By objective reasons the modern world economy can't develop without movement of borrowed funds between national economies, as well as between their entities. The world economy at the present stage ischaracterized by the inherent instability of the finances that forces the individual countries and regions to search for new economic models that provide the necessary balance between the implementation of the national interests and participation in international economic relations. Particularly urgent question is the effective debt management.

Debt Problem in the World Economy: Changes of the debt indicators for the leading countries are presented in Table 1.

The debt problem has escalated significantly during the global financial crisis, the first wave of which dates to year 2008, in many parts of the world financialcrisis began with the problems in the banking and corporate sectors. Anti-crisis measures proposed by the governments of most countries have a mixed effect. The policy of the considerable financial infusions to the economy has led to a deterioration of the financial situation of several countries. Thus, according to the OECD, there has been an increase in central government debt relative to GDP in 2010 compared to 2008: in Ireland from 28.0% to 60.7% of GDP, in Hungary - from 44.2% to 81.3% of GDP, in Greece with 110.6% to 147.8% of GDP, in Portugal - from 68.9% to 88.0% of GDP, in the UK- from 61.1% to 85.5% of GDP, in Italy - from 98.1% to 109% of GDP, in Spain - from 33.7 to 51.7% of GDP[1].

Table 1: Total public, corporate debt and households' debt (% of GDP)

	Year 2000	Year 2010
USA	198	268
Japan	410	456
Germany	226	241
UK	223	322
France	243	321
Italy	252	310

Source: [1].

A new wave of crisis that occurred in 2011 was connected with the problems of sovereign debt of several countries.

In 2012, the total public debt in the euro area was 94% of GDP, the debt of households - 71% of GDP, non-financial companies - 138% of GDP, financial institutions - 145% of GDP (Table 2). In the context of financial globalization, the debt problem even in some countries affects the interests of almost all countries of the world.

[1]OECD StatExtracts // http://stats.oecd.org/Index.aspx?DatasetCode=MEI_FIN

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Table 2: Indebtedness and Leverage in Selected Advanced Economies (in percent of 2012 GDP)

				Financial Institutions		External Liabilities		
	Gross general government debt	Gross House-hold debt	Gross non-financial debt	Gross debt	Bank claims on public sector	Gross	Net	Government debt held abroad
Greece	171	69	73	40	13	204	96	95
Ireland	118	117	289	706	28	1750	99	71
Italy	126	51	114	105	38	146	24	46
Portugal	119	104	158	59	24	285	108	64
Spain	91	87	186	115	35	225	92	25
Belgium	99	55	186	123	24	404	-65	57
France	90	67	134	172	18	296	16	58
Germany	83	58	64	97	23	219	-38	51
Euro area	94	71	138	145	-	194	12	26
United Kingdom	89	99	116	232	8	692	9	28

Source: [2, p.22]

Budget revenues of the European countries are still fragile, as the economy is recovering too slowly. Expenditures remain high due to the high levels of unemployment and fiscal stimulus measures in force.

Under these circumstances, the troubled countries of the European Union have to raise financial resources at higher and higher interest rates, exacerbating the problem of debt service. With further increase of anxiety among investors the placing the government bonds of the European countries can become difficult to perform.

Another aspect of the problem of high debt ratios is a requirement of the EU authorities to reduce the budget deficit - despite the fact that in many respects, the increasing of government spending helped to avoid serious adverse effects of the recession. This requirement creates preconditions to a drop of GDP in the European Union countries.

Buy-back program for the government bonds of the troubled eurozone countries, conducted by the ECB, helps to reduce the cost of borrowing for the countries of the euro zone and to mute concerns about the prospects for currency union, but does not solve all problems.

Many economists point out that there may be new waves of crisis. According to the former head of the Bank of England M. King, none of the causes of the current crisis is resolved. Russian economist M.Ershov notes that the debt problems are accumulated but not resolved, deficits and global imbalances persist, which significantly slows down the economic growth potential [3, p.64].

Evolution of the Russian Public Debts' Problem: One of the most severe economic problems of Russia in 90s years of the XX century was the accumulation of public debt. In the next decade the gravity of the problem of Russia's debt servicing has been decreased in the first place because of the favorable external trade conditions. However, the global financial and economic crisis that began in year 2008, has revealed new problems in the debt policy of the Russian Federation. From the 2nd quarter of year 2009, for the first time in 11 years that have passed since the crisis in year 1998, the increase of the public debt began which was caused by the need to cover the budget deficit. The issuance of Russia's Eurobonds in the international financial markets was renewed.

According to the Public debt management policy of the Russian Federation for 2013-2015 years the increase of both external and domestic public debt is planned. The main instrument to cover the federal budget deficit in 2013-2015 is the issuance of the government securities in the domestic market. In the past few years there was a tendency to increase the domestic borrowing. On the 01.01.2009 the public domestic debt amounted 1,499.82 trillion rubles, whereas on the 01.01.2013 - already 4,977.90 billion rubles, thus there is an increase more than 3 times in four years.

Both external and domestic borrowing are associated with a number of risks. With regard to external borrowing, it is necessary to mention, that the budgets of many countries are unbalanced now, the needs of sovereign borrowers in the financial resources grow, therefore, the cost of borrowing increases. In such circumstances it is necessary to work out the conditions of Eurobond issue, including the time period for issue, very carefully.

Low rates of public debt distinguish Russia from the majority of developed countries and countries with emerging markets. For a number of macroeconomic indicators Russia's economic situation is better than that of the developing countries that have 'BBB' credit rating and in some cases better than those of the "A" category. However, credit ratings assigned by international agencies for Russia indicate that our country is underestimated, which means that our external borrowings are relatively expensive.

In its turn substantial domestic government borrowing can lead to the effect of crowding out of private borrowers from the domestic market.

The Problem of Private and Quasi-Sovereign Debt of Russia: One of the consequences of the crisis in year 2008 was the escalation of the problems associated with private debt. In the pre-crisis period corporate debt has grown dramatically. In the midst of the global financial crisis, according to the Central Bank, on October the 1st, year 2008 the external debt of Russian companies amounted 275.7 billion dollars, banks - 196.4 billion dollars (excluding debt liabilities to direct investors and direct investment enterprises)[2].

Many Russian companies have experienced difficulties with the execution of their external obligations during the crisis. In order to prevent loss of control over strategic assets and to avoid reputational risks Vnesheconombank has been given the right to grant loans to organizations in foreign currency to repay loans received by these organizations prior to September 25, 2008. The National Welfare Fund became the source for the restructuring of a number of private external debt.

The situation in the sphere of private external debt complicated the activities of the financial authorities, in particular the Central Bank. The presence of a large external debt was one of the reasons of the phased (gradual) devaluation of the ruble and spending of foreign exchange reserves.

After some slowing down, the increase of the external debt of Russian companies and banks continued and according to estimates as of 1 January 2014 the external debt of the banks reached 214.9 billion dollars and the external debt of non-financial companies was 437.8 billion dollars. Private debt makes the 89% of the total external debt of Russia[3]. It should be noted that corporate debt in Russia is concentrated in a small number of large Russian companies, representing the commodity sector. There are still risks associated with the capabilities of private companies and banks to fulfill their debt obligations.

Government debt would be much higher with the inclusion of a quasi-sovereign debt. According to analysts of Deutsche Bank, the national debt, including the debt of Russian state-owned companies and banks increases by 2 times and is about 20% of GDP[4].

Public external debt in the expanded definition, that covers the external debt of governments, the Central Bank, as well as those of banks and non-bank corporations in which the government and the Central Bank own 50 percent or more of the equity, or otherwise control them, grows steadily. Thus, this figure as of 1 January 2007 was 137.1 billion dollars whereas as of July 1, 2013 - 364.7 billion dollars[5]. Now it is necessary to monitor the situation with external debt taking into consideration their concentration among a number of borrowers and the sharp rise of quasi-sovereign debt. Development of the measures to prevent a sharp rise in such debt is an urgent question.

High Level of Government Spending in Russia and in the Countries of the European Union: The common problem of the Russian Federation and the European Union is the high level of government spending. Thus, in determining the Index of Economic Freedom 2014 The Heritage Foundation Research Institute and The Wall Street Journal stated the following ratio of public expenditure to GDP: France - 56.1%, Finland - 55.1%, Belgium - 53.3%, Austria - 50.5%, Greece -51.9%, Italy - 49.8%, Germany - 45.4%. In the United States the share of public spending as percentage of GDP is 41.6%, in Canada - 41.9% Australia - 35.3%[6]. According to estimates, made by Russia’s prime minister D.A. Medvedev, the share of public expenditures in GDP of Russia is about 40%[7].

The state's total expenditure as % of GDP on average across OECD countries rose from 28.9% in 1965 to 44.5% in 2010[8]. In the second half of the 80's - 90's years some countries have reduced government spending relative to GDP, for example: Australia, Belgium, Canada, Denmark, Italy, the Netherlands, Sweden, United Kingdom.

[2]http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/debt_currency.htm.

[3]http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/debt_est_new.htm&pid=svs&sid=itm_56777

[4]Arakelyan M., Nestmann T.,2011. Russia's quasi-sovereign debt. January 27. http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000269066.pdf.

[5]http://cbr.ru/statistics/print.aspx?file=credit_statistics/debt_an_new.htm&amp

[6]2014 Macro-economic data // http://www.heritage.org/index/explore?view=by-variables

[7]http://ria.ru/economy/20111028/473531953.html.

[8]http://www.ief.org.ua/IEF_rus/ET/Dlugopolskiy206.pdf.

However, the general trend for a longer time interval indicates the growth of government spending in developed countries. In fact, during the XX century there was an increase of state influence and expansion of its functions. According to Russian economist I.Dneprovskaya, since 1917 year revolution there was almost a complete nationalization of the economy in Russia and since the 1930's years the role of the state began to grow in the economies of the Western countries as a result of the active counteraction of the governments to the fall in living standards and rising unemployment through public works and social benefits [4, p. 32]. A significant increase in government spending during the XX century is explained by the need to achieve scientific and technological progress. Because of the specificity of scientific, educational and health services as public goods, the government has to finance about half of the total expenditure on R and D and the bulk of spending on education and health care.

After the outbreak of the global financial and economic crisis, the share of public spending increased by several percentage points. This increase is caused by the need to ensure the stability of the financial system and to stimulate the economy.The largest increase in government spending as a share of GDP was recorded in Ireland (from 34% in 2005 to 67% in 2010), which was associated with the state support given to banks in the form of capital injections[9].

Not rejecting the need for government spending and especially their increase in times of crisis, it is necessary to pay attention to nuance, noted by I. Dneprovskaya: "Hypertrophic modern functions of the Western states began to work on the destruction of their economies, threatening economic security. Excess funding for social programs and social spending and not only for the native population, but also a variety of migrants, led to a huge external debt... that, in fact, suggests eating away revenue of future generations. Attempts of the national governments to increase the retirement age (France, Greece - 2010), as well as to introduce stricter discipline of financial assistance within the EU (Greece - 2010) lead to riots"[4, p. 34].

Increase in government spending and reduction of the spending effectiveness occur in Russian economy. At present, the economy of Russia follows the worst scenarios of Greece and Italy, with huge amounts of government spending as well as significant private consumption and high potential for rapid growth of public and private debt.

Efficiency of expenditures is low, which results in poor economy. The main reasons for high costs in Russia's economy are the following:

- Lack of a coherent economic strategy as well as the effective state control over expenditures, prices and inflation;
- Monopolism in the market, including the practical absence of a competitive energy market in Russia;
- Self-sufficient and the overwhelming role of the bureaucracy in the economy. Thus, according to «Doing Business 2014» study, conducted by the World Bank with theassessment of the conditions for doing business in 185 countries, Russia ranks only 92-th[10];
- Disappointingly low efficiency of the government spending and investment projects administration [5].
- Problem of contingent obligations in Russia and abroad

An important aspect of public debt and its management is the problem of contingent obligations. They are the commitments that arise for the government under certain circumstances in the future. For example, as it was shown in2008 -2009 yearsthe public mood of the adoption of specific measures by the authorities to prevent the collapse of the banking and financial system in different countries were fully justified. The same we can say about the support for international monetary and financial system as a whole.

Based on the experience of different countries, Storchak S.A. named several basic forms of the contingent obligations: state guarantees and state insurance; pension obligations for future periods; commitments of regional and local authorities; obligations under the public-private partnership; obligations of enterprises with state participation; commitments to maintain the stability of the financial system [6, p. 253].

There has been a steady increase in contingent obligations in the world economy, including the European Union. For example, the liabilities of the banking sector in the troubled countries of Europe are an important risk factor for the sustainability of the public debt. In the event of a serious banking crisis, governments have to provide assistance to domestic banks and cover their financial losses. As a consequence, a growing budget deficit and a sharp increase in the ratio of public debt to GDP are observed, which invokes doubts in the debt

[9]OECD StatExtracts // http://stats.oecd.org/Index.aspx?DatasetCode=MEI_FIN
[10]http://www.doingbusiness.org/rankings

sustainability. Irish debt crisis, which was largely caused by problems of the banking sector is just one example of such a situation.

Some official forecasts in terms of the tax burden may be underestimated due to the prevailing unfavorable demographic situation in the European Union and the Russian Federation. According to forecasts, in Greece, Spain, Germany, UK, Italy, France, public expenditure caused by the aging of the population will increase by 2.5-13 percentage points of GDP between 2011 and 2050 years [1]. Standard and Poors rating company estimated, that Russia also faces serious demographic problems (reduction of the working population, increasing number of pensioners, rising costs of health care), which may lead to an increase of the national debt to a value of 124-585% of GDP in 2050[11]. Thus, the aging of the population in a number of European countries is a significant upcoming expenditure that is not reflected in the current budget projections. A complete comprehensive account of all contingent obligations accumulated by the governments is absent, that results in the failure of the authorities to manage effectively contingent liabilities and associated risks.

Risks in the Debt Sphere: The main problem in the sphere of public and private debt of different countries is the lack of opportunities for sustainable debt refinancing through domestic and external borrowing in the required quantities and at favorable terms and conditions. As for Russia, the ability to borrow abroad is not just limited by a relatively low sovereign credit rating, but there is also the risk of reduced access to debt markets for reasons beyond the control of the Russian Federation(political situation in the world, debt crises in individual countries and regions, etc.). Itshould be noted that structural weakness of the Russian economy remains: there is the high dependency on the fluctuations ofworld prices for energy resources. Risks related to the structure of the Russia's debt include the following: historically constituted relatively high cost of public external and domestic debt; limited possibility of the public debt refinancing through domestic borrowing without significant deterioration of the debt conditions, for example, maturity; uncontrolled corporate risks including quasi-sovereign debt.

CONCLUSION

At present, it is important to develop an effective debt management strategy, linking it with the general policy of stimulation of economic growth. In this regard, one of the current problems is the development of an optimal borrowing program, which should include the limits of borrowing, as well as the formation of the optimal structure. The current increase in public debt is primarily due to expensiveness and low efficiency of the economy.

The specific Russian features are defined as follows: dependence of the state budget on world prices for energy resources, relatively low credit ratings of Russian borrowers, rapid growth of domestic borrowing, large amount of quasi-sovereign debt while the formal indicators of public debt are low.

Thus, the common problems of Russia and the European Union are as follows: worsening of conditions for external borrowing on the international capital market, significant level of corporate debt, contingent liabilities of the budgets, high levels of public spending and paternalism in respect of big business.

Both Russia and the European Union face the task of maintaining the balancein the conditions of endogenous and exogenous economic shocks. In general, the effectiveness of policy in the sphere of public expenditure, revenue and debt management varies among countries depending on the competence of their governments, developments of the institutions and the degree of political agreement in the society.

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