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THE PROBLEM OF OVER-INDEBTEDNESS IN THE CORONA ECONOMY (*CASE OF GEORGIA*)

Emzar Jgerenaia
Ivane Javakhishvili Tbilisi State University, PhD

Maka Ghaniashvili
Ivane Javakhishvili Tbilisi State University, PhD Student

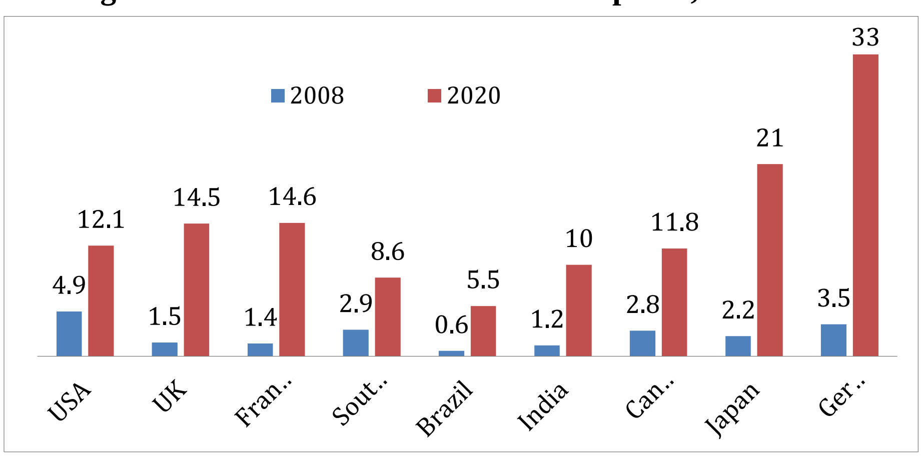
Abstract
Any economic-financial crisis, in particular, raises the issue of debt service, which has accumulated particularly excessively around the world in recent decades. The crisis caused by Covid-19 is no exception. Governments have used large-scale stimulus packages to move the pandemic crisis more or less painlessly. However, it should also be noted that these stimulus packages serve less the goals of sustainable economic growth, they were aimed at neutralizing more immediate financial and economic shocks. These steps were inevitable today, but what will follow in the years to come? Governments' debts have risen sharply since February-March of 2020. Georgia is no exception. Below, on the example of Georgia, we discuss the risks associated with public debt, assess the current situation and prospects for the near future.

Keywords: Foreign debt; Budget; Crisis

1. Introduction

There is no doubt that after the general shutdown, due to Covid-19 pandemic, that began in March, international flights, traffic bans and numerous stalled activities, the economy would need to be stimulated, and governments did so. As a result, the stimulus packages released in the first quarter of 2020 exceeded the percentage of anti-crisis packages spent on GDP during the 2008-09 financial crisis 10 times or more in many countries.

Figure 1. Economic Stimulus Crisis Response, % of GDP



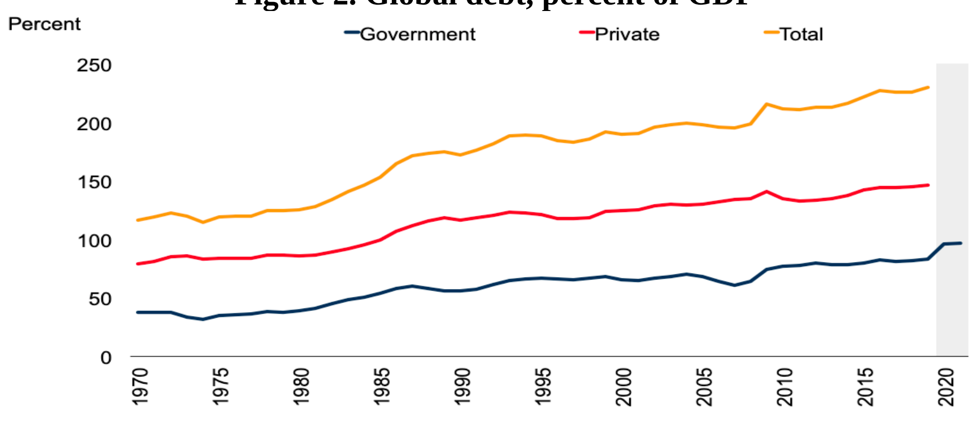
Source: McKinsey & Company

M. Ayhan Kose, Franziska Ohnsorge, Peter Nagle and Naotaka Sugawara discussed[1] the three debt waves before the current crisis in the period 1970-2009:

1. The first period is 1970-89, which is characterized by a combination of low real interest rates and rapidly growing syndicated debts. Which encouraged developing and low-income countries (especially in Latin America and sub-Saharan Africa) to borrow large loans in the 1970s. This led to a series of financial crises in the 1980s. Which has become an impediment to economic growth and development over the next decade.
2. Liberalization of the financial and capital markets in 1990-2001 allowed banks and businesses in East Asia, the Pacific, and governments in Europe and Central Asia to borrow large amounts, usually in foreign currency, that was followed by series of crises in 1997-2001. Large-scale banking and corporate bailouts were needed to solve problems associated with private debts, often with the support of the International Monetary Fund (IMF) and the World Bank.
3. In 2002-2009, loans from the head offices of European megabanks in Central Asia and Europe increased, which was caused by simplification and reduction of regulations. This led to the crisis and recession of 2007-09. Bailouts and the support and intervention of international organizations again became necessary.

It can be said that today the world is facing a new debt crisis. After fiscal measures in many countries, it became possible to neutralize such instantaneous factors as declining revenues, a sharp decline in international trade, reduced tourist flows, and so on. But at the same time, the growth rate of global debt in both the public and private sectors is alarming. After the global financial crisis, global debt has grown to 230% of global GDP. The debt-to-GDP ratio of developing countries is at a record high - 170% (Figure 2 and Figure 3), at the same time, in about 40 countries with developing economies, government debt is more than 20% of GDP, which is higher than it was in 2007. About a third of the debt of developing countries is denominated in foreign currency, which creates even greater risks[1] in the face of currency fluctuations and uncertainties.

Figure 2. Global debt, percent of GDP



Source: International Monetary Fund; Kose et al. (2017); World Bank

Even if the global financial system is able to escape the financial crisis, the debt accumulated in response to the pandemic will become a brake on stable economic growth in the long time perspective. As global activity declines, interest rates will rise. Increased debt service costs are likely to be financed through sources such as raising taxes, taking out additional loans, or reducing other costs. Which does not bode well for the economies.

2. Literature Review

Despite the short period since the pandemic erupted around the world, many papers have already been published discussing the impact of Covid-19 on the economy. In this case, we are specifically interested in researchს related to the debt sector. For both companies and households, the process of over-indebtedness and increased debt is a major topic of discussion among various authors, such as Boissay and Rungcharoenkitkul, 2020. The model developed by Elenev (2020) considers the impact of Covid-19 on the reduction of employee productivity, which reduces the employment rate, and this has a direct impact on companies. This results in lower revenues and problems with debt service creating the risk of corporate default. Baker (2020a) discusses consumption habits and forms of debt response under Covid-19. Given the historically low levels of high government debt and interest rates that exist in most developed countries, Bianchi (2020) offers a coordinated monetary and fiscal policy to respond appropriately to pandemic shocks. According to the author, fiscal policy should be used to implement the emergency budget with a debt-to-GDP rate. This will increase aggregated costs and inflation and lower the real interest rate. The monetary authority should act in coordination with the fiscal policymakers by targeting the above-mentioned inflation rate. In the long run, the government should try and balance the budget and the goal of monetary policy in the future should be to return to normal inflation. In the study below, our reasoning is also devoted to debt-related issues.

3. Research Methodology

During the research process empirical research method is used. The empirical evidences are gathered using market research, data analysis and literature review methods.

Stages of the research:

3.1 Formulation of the Problem

Any economic-financial crisis, in particular, raises the issue of debt service, which has accumulated particularly excessively around the world in recent decades. The crisis caused by Covid-19 is no exception. Our research is focused on the debt problem, both, around the world and, particularly, in Georgia.

3.2 Gathering of primary data

Main source for the research is data gathered from the international organizations and local governmental and statistical data softwares: World bank, International Monetary Fund, International Labor Organization; National Bank of Georgia; Ministry of Finance of Georgia, Ministry of Economy and Sustainable Development of Georgia and National Statistical Office of

Georgia. We also used reports from financial institutions and different kind of articles on the web.

3.3 Conducting data analysis and framing the results

Data analysis is done quantitatively.

3.4 Making conclusions.

The last step for our research is making conclusions and suggestions due to Georgian government debt and its' conditions for the near future.

4. Data Analysis and Results - Case of Georgia

The budget of the measures envisaged by the first and second stages of the anti-crisis plan of Georgian Government for Covid-19 during 2020 includes: 1. Caring for citizens and their social support in amount of 1.04 billion GEL; 2. Caring for the economy and supporting entrepreneurs - 1.76 billion GEL; 3. Strengthening the health care system and fighting the pandemic - 350 million. GEL[1].

Against the background of declining economic activity, according to the International Monetary Fund, the Georgian economy is expected to shrink by 4% by 2020, although the economy is expected to grow by 4% by 2021.

As in many tourism-dependent countries, the most affected sector in Georgia is tourism. In the first quarter of 2020, revenues from international visitors decreased by 26% compared to the previous year. In total, 55% decrease in service exports is expected in 2020, which envisages reduction in revenues from international visitors by 70%. The decline in tourism is having a negative effect on other sectors of the economy, including construction and real estate. Globally, foreign trade is weakening, and already in April 2020, Georgia's exports fell by 28%, while imports fell by 39%. According to the International Monetary Fund's forecasts in 2020 exports are expected to decline by 24.2%, while imports are expected to decline by 21.1%.

The current situation increases the pressure on the exchange rate. During 2020, like the currencies of other developing countries, the Georgian Lari exchange rate experienced large fluctuations and fell sharply.

[1] Measures Implemented by the Government of Georgia against Covid-19 (https://stopcov.ge/Content/files/COVID_RESPONSE_REPORT__ENG.pdf)

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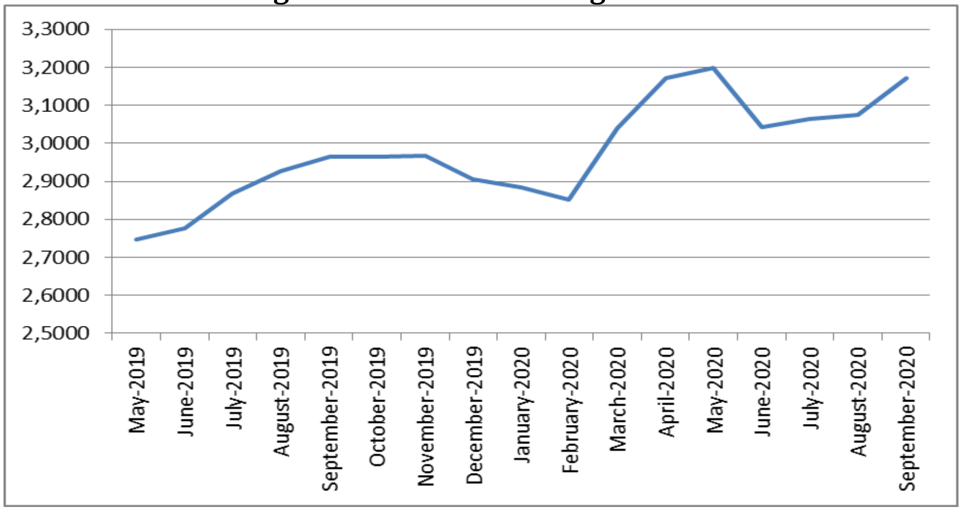
Figure 3. US Dollar/Georgian Lari



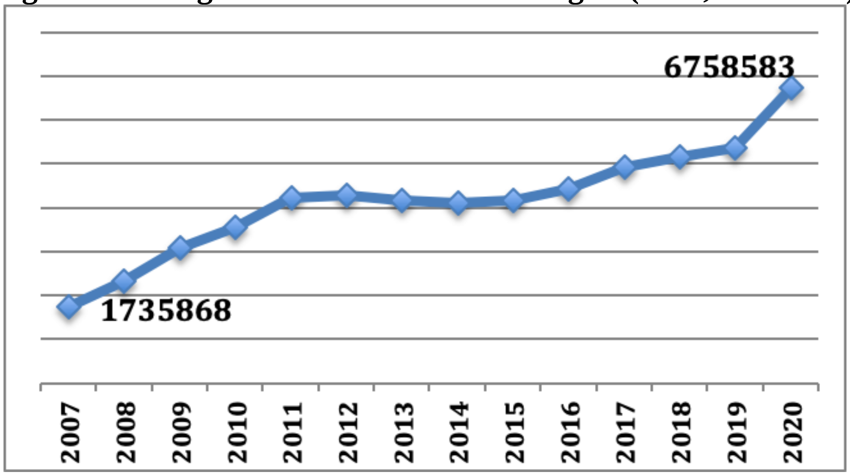
Source: Authors' own conception; National Bank of Georgia data (nbg.gov.ge)

The decline in global foreign demand and the ongoing economic crisis in the countries are also having a negative impact on the volume of remittances. In turn, remittances are an important component of domestic demand and, consequently, its reduction has a negative impact on domestic consumption. As of April 2020, remittance enrollment was decreased by 42.3%, Among them, a large decrease is observed from countries such as Russia (-61.8%), Italy (-27.5%), Greece (-37.9%), USA (-33.6%), Israel (-48.4%). These countries are the main locations of Georgian emigrants and these countries account for a large share of cash flows to Georgia.

The shrinking of the economy, as well as the increase in the costs associated with pandemic management, have a direct impact on both budget revenues, especially tax revenues, and expenditures. Revenues planned for the consolidated budget of Georgia in 2020, without grants and loans provided by international partners, were projected at 13.7 billion GEL, which according to the updated forecasts will be decreased by 1.8 billion GEL. In addition, it became necessary to use the support of the international organizations. Georgian government has attracted 1.5 billion USD budget assistance in total, including: IMF – 200 million USD; ADB – 400 million USD; WB – 250 million USD; AFD – 200 million USD; KfD – 250 million USD; EU – 200 million USD; AIIB - 100 million USD.

As a result, as in the rest of the world, the total amount of public debt in Georgia has increased. Both the government's external and domestic debts have increased (Figure 5 და Figure 6).

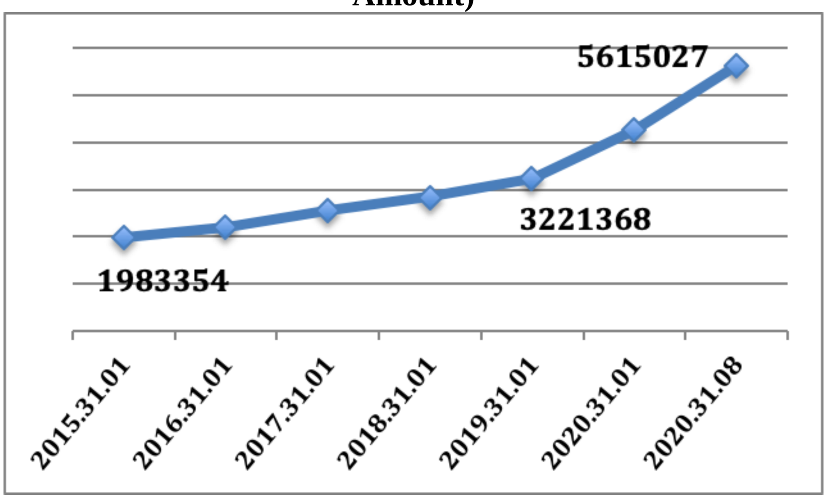
Figure 4. Foreign debt of the state of Georgia[2] (USD, thousand)



Source: Authors' own conception; calculation based on Ministry of Finance of Georgia data (mof.ge)

Georgia's domestic debt is also increasing from year to year, with significant growth by 2020. The main sources of domestic debt are treasury securities (6 and 12 month treasury bonds and 2, 5 and 10 year treasury bonds), bonds for the National Bank of Georgia and bonds for open market operations. As well as debt to budget organizations in the form of loans (the latter in small portions).

Figure 5. Georgia Domestic Government Debt (Thousand GEL, Outstanding Nominal Amount)



Source: Authors' own conception; calculation based on Ministry of Finance of Georgia (mof.ge)

[2] The data are updated with the data of August 2020, the data of the previous years are taken accordingly with the August figures.

According to all the scenarios discussed in the Government Debt sustainability assessment, the government debt to GDP ratio is increasing. Government debt sustainability analysis is based on International Monetary Fund (IMF) methodology and modified according to country specifics[3]. It should be noted that in case of 30% depreciation of GEL against the US dollar, the government debt to GDP ratio exceeds the critical margin. In response to the above economic shocks, as a result of increased debt liabilities, the projected debt-to-GDP ratio at the end of 2020 is 54.4%. As stated in the "Debt Sustainability Document" published by the Ministry of Finance of Georgia in June 2020[4].

However, this is in the case when the 4% real GDP growth rate in 2021 is taken as a baseline scenario when assessing debt sustainability according to the IMF methodology, in 2022 year - 6%, and in 2023 year - 5.8% indicators. And for the alternative scenario, real GDP growth in 2021 is taken at 2.5%, in 2022 at 6% and in 2023 at 5.8% indicators. As for the baseline scenario, 4% reduction in the economy is considered, while according to the alternative scenario reduction of 5.5% is expected in 2020. According to a report released by the World Bank in June, reduction by 4.8% is expected the country in 2020[5].

In addition, international organizations, the same World Bank, offers three scenarios of events. In our estimation, this should also be taken into account when assessing readiness for future debt service. If according to the baseline scenario global output is expected to decline by 5.2% in 2020, the decline under the pessimistic scenario will be 8%. In developed economies this figure will be 10%, while in developing economies it will average 5%. As for the pessimistic scenario, the growth forecast for 2021 is 1.3% for developed economies and 2.7% for developing economies. When we talk about debt sustainability, we have to consider this scenario as well. The fact is that Georgia's public debt ratio is likely to exceed the Maastricht agreement figures, including the 60% for GDP. In Georgia the situation is complicating with the fact that the country will start servicing its debts in 2021. At the same time, the capital market and pension system are under reform in the country.

Suppose public debt in 2021 is increased by billion 200 million USD, and over the next few years by an average 1 billion USD as well. Envisaged that this will add to the amount of debt service which is already available (2021 year - 868 million USD, 2022 year - 397 million USD, 2023 year - 404 million USD, 2024 year - 436 USD and 2025 year - 448 USD (Figure 6)), The pressure on the state budget is growing too much. In addition, the debt service figures mentioned above are valid only if the government no longer takes a loan and we are counting the debt service amount on the balance as of June 30, 2020. The second question is how realistice it is. While the country has already borrowed about 1.5 billion USD in just the first few months of the pandemic, mostly for social spending and budget assistance, it is hard to imagine that under the current fiscal policy, the economy will be able to recover only with budget funds from 2021. We

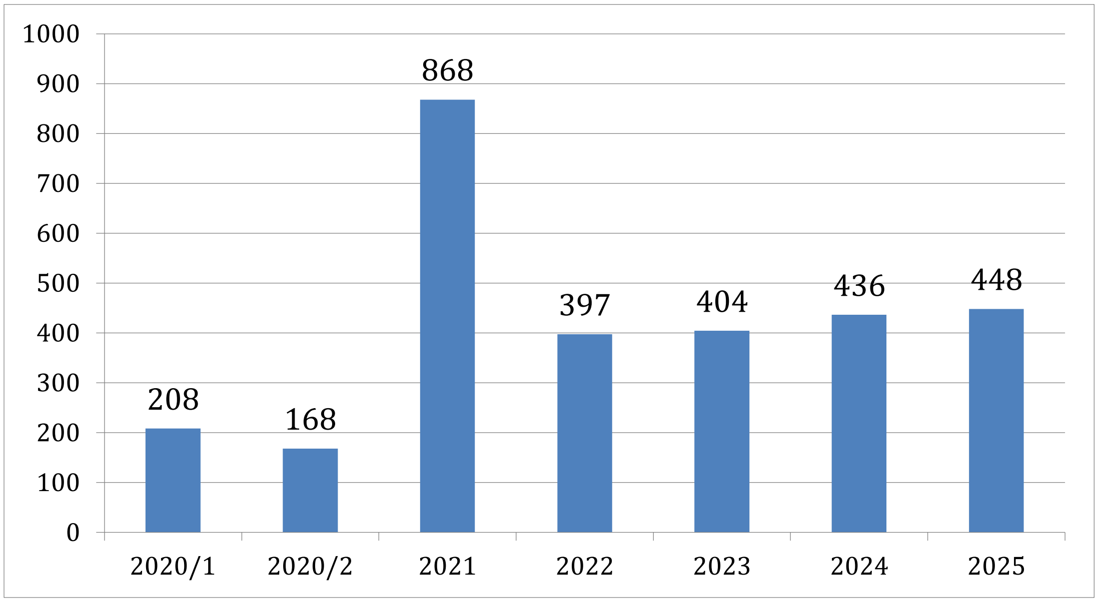
[3] https://www.imf.org/external/pubs/ft/dsa/mac.htm

[4] https://www.mof.ge/images/File/2020%E2%80%93biujeti/01-07-2020/danartebi/DSA-FInal.pdf

[5] Global Economic Prospects, World Bank, June 2020, p. 80

should not forget that since January 1, 2019, Georgia is undergoing a complex reform of the pension system, which is also a big pressure on the budget.

Figure 6. Public external debt service (million USD)



Source: Authors' own conception; calculation based on Ministry of Finance of Georgia data (mof.ge)

5. Conclusion

Pandemic shocks have significantly worsened Georgia's economic growth prospects for 2020. It is expected that the slowdown in economic growth in Georgia's trading partner countries will have a negative impact on the country's exports and remittances. And as the global uncertainty surrounding the pandemic continues, capital inflows and planned investments in the economy will be reduced.

We also consider the limitation of our research paper: the research is mainly built on the situation caused by the current pandemic crisis in the world economy. Countries' economies deftly maneuvered through the first stage of the coronavirus pandemic, thanks in part to an aid packages that sought to prevent insolvencies, mass layoffs and a rise in poverty. Just as many other countries, Georgia, thought its economy was out of the woods, however, a potential second wave of infections is now on its way (in the case of Georgia, it is much greater than the first one). That is why, it is impossible to predict the economic future and do a full analysis now. The future is still unclear. We do not know how difficult the second wave will be, how long it can last, and how more debt sources governments may need. Therefore the results of the study may need to be revised in the coming months, presumably due to altered statistics.

But, for this moment, by analyzing the available data, we can conclude that today almost every country in the world is already facing an over-indebtedness crisis, with governments spending more than they have budget revenues, leading to disaster. Georgia is no exception: budget expenditures for debt service are expected to increase sharply in Georgia too in the near future, at the same time the country is accumulating new debts. A developing country like Georgia has less chance of raising funds in the global bond market, besides this, the resources of international organizations are limited. Therefore, Georgia and similar developing countries have to find a new way how to deal with deep economic problems in the near future. In our opinion, budget expenditures should be reduced immediately, especially in the social direction, and borrowing should be stopped in 2021-22. The budget should be directed towards investment costs. At the same time, pension reform in Georgia should be suspended for at least 2 years.

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