

THE COMPARATIVE ANALYSIS OF STATE DEBT AND ITS MANAGEMENT

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Abstract

Purpose - Effective management and optimal cost of a state debt are relevant to every nation. Since the recession the management of a state debt has become increasingly important to the Republic of Lithuania. Significant liabilities had to be made in pursuance to cover up a budget deficit. Therefore, the ratio of the state debt and GDP have increased more than twice. In the future, refinancing previous debts is to remain a key goal of borrowing. Consequently, the effective management of the state debt will remain a relevant topic in Lithuania and other states of the EU for a long time to come.

In the past state debt grew mainly at times of threat to the national security or recession of economics. Borrowing is inevitable in many countries in order to stimulate the growth of national economy. When state's expenditure exceeds its income, the state is forced to cover up the resulted difference most frequently with borrowed funds. Debts and other financial liabilities caused by such borrowing in state's name forms the national debt. The government is able to finance and support certain branches of economy and social groups, thus pursuing its political objectives, by controlling the national debt and taking over its liabilities. State's borrowing demand is a sum of government's expenditure formed over budget year, which is expected to be financed borrowed funds. This article analyzes borrowing demands of Lithuania and other Baltic states and the factors determining their state debt management. One of the main methods of satisfy government's demand to borrow funds is by emitting government securities.

Design/methodology/approach - analyses of the scientific literature

Findings and originality – borrowing in name of the state maintains an important influence on strengthening its financial systems and supplying them with necessary funds, while available interior recourses are limited. State debt management is an integral part of general state economy politics.

Research type - theoretical analysis

Keywords: State debt, debt management, budget deficit, government policy and regulation, servicing costs

Introduction

Public debt and the causes of economic research relevant to the subject matter, as the state of economic development is a significant factor. High level of debt is a burden to the economy because the larger the debt, the more the state budget funds should be used with its service, the interest payments and repayment of the debt. The budget deficit, large investment projects, whose implementation would require significant resources and other reasons for the emergence of the debt and further development. The budget management system is topical for the modern capita of the state, since that what the state budget and public debt, the population belongs to the social environment, even the standard of living, it is important to clarify what must be the optimal amount of debt, make a positive contribution to the economy, and it must find ways to the proper and rational exercise of public debt management.

The governmental borrowing does not cause damage to the economy if only the opportunities provided by debt are used in an optimal way. It is important to learn what level of the fiscal deficit is acceptable to the state and how it could be managed under certain economical conditions. In making a choice for the criteria needed to determine the acceptable level of the budget deficit, it is indispensable to make a notice of the possibility to apply those criteria, e.g. in analyzing and forecasting.

Nowadays, the topic of a national debt in various states is one of the most discussed subjects in Economics. In 2012 the refinancing sum of all the largest countries put together exceeded 8 trillion dollars⁹, most of which had to be funded or refinanced by Japan – three trillion dollars. Also, the Eurozone states had to pay back a significant sum – almost a trillion euros (837 billion). According to Elwin de Groot, an economist of “Rabobank” from the Netherlands – “Those are huge numbers. Especially because most of the nations have a deficit in their budgets, the debts are growing, thus this sum raises an immense problem”. Poor management of national debt in Greece, Cyprus and Italy resulted in cardinal problems for the whole European financial system and the euro. For example, the Netherlands and

⁹International Monetary Fund. Global Financial Stability Report (2012)
[http://www.imf.org/external/pubs/ft/gfsr/2012/01/pdf/text.pdf\[interactive\]](http://www.imf.org/external/pubs/ft/gfsr/2012/01/pdf/text.pdf[interactive]) accessed on 21
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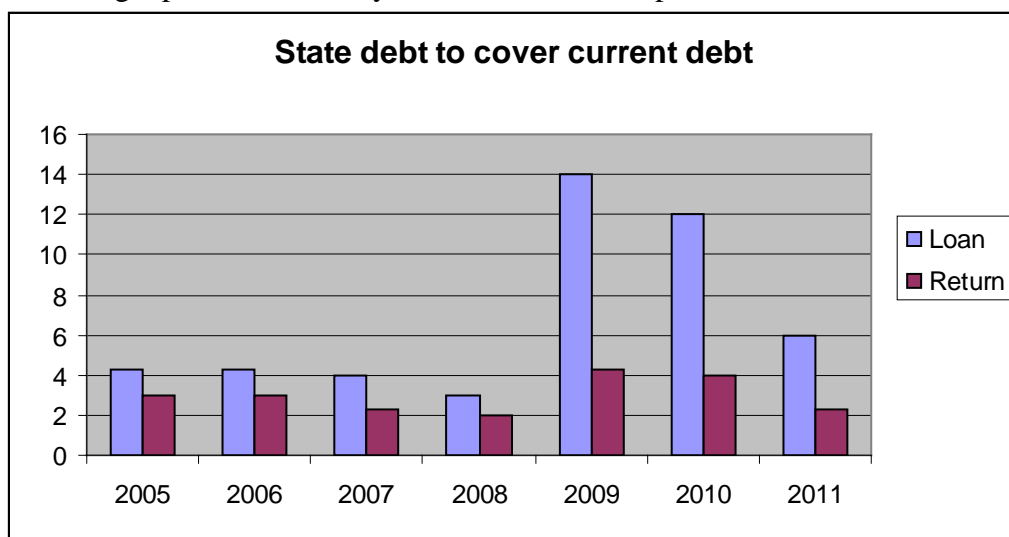
Greece have to reinstate up to 30 billion each, while Belgium – 24 billion euro.

Table1 Repayment or Refinanced of Debt in 2012

Country	RedeemableDebt Securities, 2012(EUR billions)
Italy	193
UK	165
Germany	157
France	100
Spain	46
Greece	30
Netherlands	30
Belgium	24

Source: HSBC (HSBC Holdings plc)

A delicate position emerged not only in the Eurozone, but in the periphery of the zone too. For example, Lithuania had to refinance 1 billion euro (3.45 billion litas) worth of bonds: by 10 May 2012 the state bought 400 million euro worth of bonds which were released in 2002 and then added the emission of 600 million euro worth of bonds in 2006. However, according to the budget plan of 2011 only 1.7 billion litas was provided for this cause.



Source: <http://www.finmin.lt/web/finmin/leidiniai/skola>

Figure 1.State debt to cover current debt

At this moment, the risks of refinancing and the need of borrowing for 2013 are being minimised (if there were unfavorable conditions for borrowing at financial markets). There is a 2.2 billion litas worth reserve for this cause. Our neighbour Latvia has found itself in a difficult situation none the less – in 2012 the state had to bring back a total of 345 million euro, which is a threatening sum.

In the year of 2014 the government of Lithuania is planning to borrow 6.9 billion litas to finance the deficite of national budget and to redeem 500 million euro worth of euro debt obligations, published in 2009, by the middle of June. A sum of 4.8 billion (out of mentioned 6.9 billion) litas is foreseen to cover up the return of state debt. The prognosed resulted public finance deficite in 2014 is 1.9 percent of GDP, which requires about 2.4 billion litas of borrowed funds.

Speaking of the coming of 2015, by the mid January state must buy out the a total of 1.5 billion litas worth of debt obligations published in 2009. Whereas Lithuania is preparing to fund this debt by borrowing upto 3.5 billion litas. It is for this reason that the whole prognosed sum of governmental borrowing will reach about 10.4 billion litas.¹⁰

While realizing the global situation, effective debt management expenditure optimisation became relevant to each and every nation.

Since the recession national debt management has become increasingly important to the Republic of Lithuania,when significant liabilities had to be made in pursuance to cover up the budget deficit. Therefore, the ratio of state debt and GDP hasincreased more than twice.Though, many economists retain by their stance that the developing market economies with effective international connections cannot be threatened by the budget deficit and national debt. The process continues to a certain limit.

The comparative analysis of state debt and its management

Based on that the main objective of states state debt management is to ensure total funding of all state expenditures by the end of their terms and the implementation of all state's liabilities with at least of expenses with the most acceptable risks, not exceeding the fixed limits of state debt and borrowing, the Ministry of Finances, in pursuance to manage state debt at most effectiveness, is implementing a program "Debt management is state'es name", launched in 2009.¹¹Furthermore, Ministry of Finances monitors the implementation of requirements of EU towards it's new members, pursuing to become part of Economic and monetary union.

The government borrowed 11.9 billion litas in 2010 to ensure demands of borrowing by emmiting government securities abroad and in Lithuania and by obtaining a loan from foreign creditors. By the end of 2012 the foreign inverstor acquired portion of government securities had decreased from 5.45 to 4.56 percent, calculating from all of the existing in

¹⁰Lietuvos Respublikos Finansų ministerijahttp://www.finmin.lt/web/finmin/aktualus_duomenys[interactive][accessed on 21 03 2014]

¹¹Dėl Konvergencijos 2011 metų programos ir nacionalinės reformų darbotvarkės. 2011 m. balandžio 27 d. Nr. 49Valstybės žinios, 2011, Nr.54-2596.

circulation and registered in “Lithuanian central depository of government securities”. Main investors in 2012, alike 2011, had remained the same of Latvia and Estonia. Estonia had a sum of 137.65 million litas worth of government securities by 2011, and 129.0 million litas by 2012, while Latvia acquired 89.37 million litas by 2011, and 80.6 by 2012. Investors of Finland bought 10.36 million litas worth of government securities in 2011, investments from Great Britain reached 49.4 million litas worth of government securities.¹²

In 2010 creditorial ratings of Lithuania remained stable, the cost of credit ensurance risks and the governmental borrowing costs, compared to the situation of 2009, had decreased. Average profitableness had shrunk to 3.8 percent in 2010, from 7.8 percent in 2009, and still decreased in 2011, because of relatively lower interbanking interest norms than of 2010, for which Lithuanian banks had been preparing a financial loan for other banks (VILIBOR). The growth of economy in 2012 caused the cost of borrowing to decrease, thus in 2012 emitted by the means of auctioning government securities of all terms in the currency of litas had a lower average of interests norms from 3.02 to 2.44 percent. The average of annual treasury bill interest norms had decreased from 2.22 percent in 2011 to 1.31 percent, while the indicator had grew from 4.35 to 4.56 for other bonds. This growth of bond profitableness was caused by borrowing with longer terms than in 2011. (see fig.2)

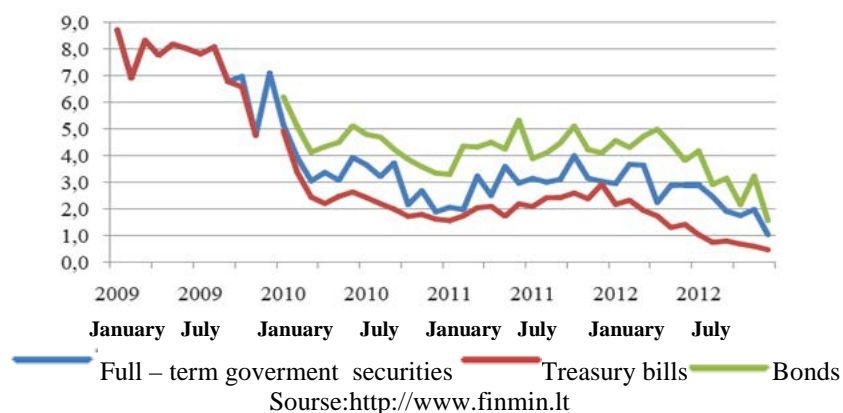


Figure 2: The (percentage) development of an annual weighted average profit from government securities denominated in Litass in the period from 2009 to 2012.

As it was mentioned before, all of the governmental debentures are facing risks, therefore by managing state debt all of the managers must

¹²Valstybės skola 2012 m., http://www.finmin.lt/finmin.lt/failai/leidiniai/failai/Skola_2012_LT.pdf [interactive] accessed on 2013 11 13]

estimate the main risk factors¹³, i.e. the alteration of currency exchange rate and norms of interest and the management of credit, refinancing and activity risks.

Debentures with interests of Republic of Lithuania accumulated in pre-recessionary period until 30th of June, 2008 amounted a total of 21.34 billion litas (of which 16.63 billion litas were foreseen to refund the debt with 4.72 billion litas worth of state debt interest), as it was mentioned analyzing the structure of the state debt, must be fully refunded by 2023 (inner debenture refunding must be finalized by 2016 and the foreign – by 2023)¹⁴.

By the 31st of December, 2010, state debentures with interests amounted a total of 45.862 billion litas, out of which debentures were worth 34.353 billion litas with the interests of 11.509 billion litas. Terms for those debentures are from the year of 2011 to 2035.. Main refunds of these debentures were foreseen to be carried out by 2012 - with a portion of 4.255 billion litas, 2013 – 4.360 billion litas and from 2014 to 2017 with a total of 4.761 billion litas. Nevertheless, in April 2013 Lithuanian government had announced that there will be an additional borrowing of 7.3 billion litas, out of which 6.7 billion would be designated to refund previous debts with interests.¹⁵

Already Lithuania has bought out 1 billion worth of bonds, emitted in 2003 – 2004. At least a few billion will be added to a sum total of 43.157 billion litas, registered on the last day of previous year.. Since the year 2003 until the end of 2007 state debt rose by 3.3 billion litas, whereas in the period of 2008 - 2012 by a dramatic increase of 27.1 billion litas.

The assumption that the global recession of economy has had a huge impact towards this outcome is not to be excluded. However, over the upcoming years the sum, designated to refund state debt, will continue to rise: a sum total of 2.341 billion litas worth of interests were payed out by 2011, 6.132 billion by 2012 and 6.7 billion by the year of 2013. The fact that state debt is continuing to require progressively larger financing is backed up by other tendencies in ratios between indicators of macroeconomics.¹⁶ As it is stated in „SEB bankas“ publication „The overview of Lithuanian macroeconomics“, the debt of governing sector over the fourth quarter had

¹³Martinkus B., Žilinskas V. *Ekonomikos pagrindai*. Kaunas: Technologija, 2001, p. 667

¹⁴Valstybės skola 2008/ Lietuvos Respublikos Finansų ministerija, Vilnius, 2009. – 26 p.

¹⁵Valstybės skola 2012 m.,

http://www.finmin.lt/finmin.lt/failai/leidiniai/failai/Skola_2012_LT.pdf [interactive][
accessed on 21 03 2014]

¹⁶Lietuvos Respublikos Finansų ministerija

http://www.finmin.lt/web/finmin/aktualus_duomenys[interactive][
accessed on 21 09 2013]

risen by almost 1 billion litas, however the ratio between it and the sum GDP of all four quarters had not had a significant change because of sizeable growth of GDP. The prognosis concerning the growth of GDP in the year of 2014 and 2015 remains unchanged – GDP should grow by 3.5 and 4 percent in that particular order.¹⁷

The ratio between state debt and GDP has risen by 13.8 percent since 2009 and continued to do so, by the end of 2011 this ratio was higher by 23.9 percent than it had been in 2008. Whereas at the beginning of 2008 Lithuania overlooked the warnings of international agencies of crediting about need to implement means of inflation management and to stricken fiscal politics, for the first time since 1990 loan ratings towards Lithuania were reduced.. This made the cost of governmental borrowing and had it's impact on state economy and financial sector.

By analyzing and evaluating state debt management's expenses one can notice, that of recession of economics, when governmental income had decreased and sum total of payed interests rose, the value of this indicator in 2012 has changed and amounted a 5.9 percent.

Ever since the year of 2000, when this indicator reached 4.78 percent, has been steadily decreasing. For example, in 2008 this value amounted only 1.94 percent, but by the time of recession of economics in 2009, when governmental incomes were diminished and the sum total of payed interests rose, this value shot upto 3.68 percent, and 5.36 by 2010. Since the year of 2004 mentioned sum totals are included in overall state debt.

In 2012 the expenses of state debt management reached about 2.06 billion litas, 2011 – 1.85 billion litas, which grew with including of interests and the emmission of goverment securities upto 2.04 billion litas, in the year of 2011 respectively – 1.848 billion and 1.833 billion litas, in 2010 – 1.695 and 1.675 billion litas. In 2012 the expenses of state debt management (without interest payments), compared to the situation of 2011, increased by 13 percent or by 2 million litas, and by comparing the situation of 2011 with 2010 – decreased by 25 percent (5 million litas).Expenses of interest payments in 2012, compared to situation of 2011, had grew by the value of about 12 percent, and in 2011, compared to 2010, - about 9 percent.This was determined by the state debt growth of 2010 – 2012 period by a nominal value, in order to ensure the financing of state budget deficite.

State budget deficite increases alonside the growth of state government expenses. State debt management expenses can be minimized with an effective management of state's monetary resources with the use of temporarily unallocated funds of governmental foundations even at times of retaining tendencies of rising debt management expenses.

¹⁷Lietuvos makroekonomikos apžvalga.rugsejis, nr.52

An effective management of state debt was a priority among the tasks of the government of Republic of Lithuania since 2010 (government's meeting protocol no.78 of 14th October, 2009)¹⁸. According to the National agreement, which was approved by government of Republic of Lithuania with provisions of protocol no. 1335 by 21st October, 2009, to implement politics for national borrowing of avoiding the limiting loaning credential resources for subjects of economy because of financing the budget's deficite.

The program of Lithuania's convergence 2011 indicates, that short-term liabilities in accordance with residual duration consists of 5,5 percent of the whole state debt, while variable norms of interest amounts a 2,8 percent. An average residual duration consists of 5 – 6 years.¹⁹

Actually there are two most frequently applied state debt management's models:

- Ministry of finances (or treasury), which is applied in Lithuania, Iceland, Bulgaria, Latvia and Norway;
- Agencies of debt and monetary resources management, fount in UK, Austria, Portugal, Germany and Netherlands.²⁰

In either case of applied model, the main purpose of state debt management is to ensure that demand of financing liabilities would be held at least of expenditure and with comprehensible risks.. This means that by managing state debt, balance between the risks and cost of borrowing and required.

By the end of 2011 state debt amounted a 41,736 billion litas. Compared to 2010, it grew by 5,148 billion litas or 14,1 percent. Annual growth of ratio between state debt and GDP reached 0,9 percent and by the end of 2011 amounted 39,4 percent of GDP.²¹ By the end of 2012 it was 41 percent of GDP (compared to 38 percent in 2010). Thus, the dependency between the groth of state debt and it management's expenditure is obvious. The main part of financing was used on interests of borrowing. By 2013 they grew upto 2,4 billion litas.

Whereas by analyzing the problems of state debt various indicators are being used as ratios between state debt and portions of inner or foreign

¹⁸http://tm.lt/dok/Vyriausybyb%C4%97s_protokolas_78.pdf [[interactive]] accessed on 2013 11 12]

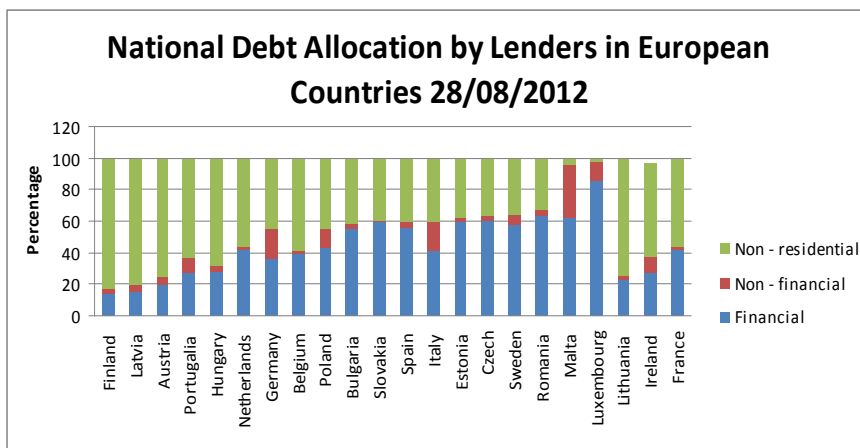
¹⁹Lietuvos Respublikos Vyriausybės nutarimas Nr. 491 “Dėl Lietuvos Konvergencijos 2011 metų programos ir nacionalinės reformų darbotvarkės“. *Valstybės žinios*, 2011, Nr.54-2596

²⁰Buškevičiūtė E. *Viešieji finansai*. - Kaunas: Technologija, 2008. - 332p

²¹Lietuvos Respublikos valstybės kontrolė, Išvada dėl LR 2011 metų valstybės finansinių ir biudžeto vykdymo ataskaitų rinkinių, 2012 m.rugsėjo 24 d, (<http://www.vkontrolė.lt>) [[interactive]] accessed on [2013 11 09]

debt, GDP with debt management expenditure and GDP²² the exact size of state debt can be determined and frequently warn if state borrowed finances can further be used as a regulator for state economical and social development.

The situation becomes unstable and hardly manageable if state debt and it's cost of management are growing quicker than GDP. In the scenario of state's inability to deal with deficit budget, the risk of financial and fiscal crisis becomes probable. Foreign portion of state debt can essentially change the situation, by creating the burden for future generations. Certainly, this could be perceived not as carrying out the burden put by our fathers, but nevertheless by facing this kind of situation, future generations will dispose with less of capital than it could. In Lithuania the portion of internal debt was one of the smallest in Europe in 2012. (see fig.3)



Source:EUROSTAT

Figure 3: National Debt Allocation by Lenders in European Countries 28/08/2012

There were only three European countries that had a smaller portion of national internal debt in the second half of 2012. In that period the portion of financial investors consisted of 22.9 percent in the whole debt. This portion was smaller in Finland, Austria and Latvia.

The portion of non – financial individual investors and non – financial enterprises made up 3.3 percent of Lithuanian debt in the second half of 2012.

It is borrowed from internal financial markets directly from citizens by issuing treasury notes or from enterprises and through financial companies. By the end of 2011, treasury notes reached only 0.1 percent of the debt while in pursuance to amount a limit of 5 percent treasury notes

²²Štuopytė Ž.,Valstybės skolinimosi poveikio verslo aplinkai prognozavimas. – Kaunas: Technologija,2004.96 p.

should reach a total worth of 2 billion litas²³ in the national debt portfolio. It is best to rate the potential of treasury notes by evaluating which part of the market it could obtain beside other saving measures used by companies and citizens. A dominant method of investment for citizens and companies was deposit investment. According to the specialists of the Lithuanian Bank and the Association of Lithuanian Banks, during the past nine years non – financial company deposits and saving deposits grew twice in numbers. Moreover, during the same period civil deposits have grown by more than three times in quantity. An assumption could be made that the amount of invested capital into treasury notes could have grown proportionally. Investment of non – financial companies during the same nine years increased from 0.3 to 1.1 percent of the whole national debt.

Most common investors choose mutual or private accumulative pension funds for their investments. On the basis of data provided by the Lithuanian Bank, in 2012 there were nine working companies in Lithuania that managed 4.7 billion litas worth of private accumulative pension funds. There were more than 51 percent of finances invested out of all pension funds in the most popular mid share stock pension funds in September 2012. Likewise, pension fund companies are investing in bonds issued by the Lithuanian government where the size of investment in national stocks depends on the risk type of a pension fund. However, there is a noticeable ineffectiveness in a process of investment in national stocks issued in international markets. That means that the pension funds are forced to invest through intermediaries. In the period of 2011 – 2012 the portion of internal debt in the whole national debt was one of the smallest in the EU. In pursuance to increase the portion of citizen investments in national debt there should be means of encouragement implemented to invest into treasury notes, thus, enlisting additional 1 billion litas. Additional 0.3 billion litas can be drawn entirely from accumulative pension funds alone. In order to increase the amount of national stocks in auction market, it is imperative to draw more investors. At the moment eight banks are active and there are twelve bank branches in Lithuania. Only eight of them were national stock auction participants. For example, Swiss capital banks, that are active in Lithuania, are evaluated to approximately 3, 500 billion litas. If there could be means to draw 0.1 percent from their managed capital to investments in national stocks, a sum of 3.5 billion litas could be amounted. By implementing all these measures in the inner market 4.8 billion litas could

²³Lietuvos bankas. Pagrindiniai bankų veiklos rodikliai. Požymiai: Pinigų kiekis bankuose, 2003 m. <http://www.lb.lt/2004_nr__1_1_1>.[interactive][accessed on 21 09 2013]

be borrowed. This could increase the portion of internal debt by 12 percentage points, thus, reaching a total of 38 percent of state debt.

The comparative analysis of state debt management in baltic states

National debt management includes terms of borrowing and determination of its principles of use and its size and borrowing control and data, related to the debt, gathering and usage²⁴. Analysts of the International Monetary Fund define the national debt management as a process which sets a state debt management strategy and means for its fulfillment. The International Monetary Fund distinguishes these main purposes to ensure the state liabilities and obligations to be implemented with the smallest expenditure from mid to long term periods. Such Lithuanian authors, as Leviškauskaitė and Rūškys, agree with this proposition presented by the experts of the IMF. They emphasise that the main problem with the national debt enlargement is its expenses because of the fact that more and more funds are being redirected towards debt management rather than invested into the national economy. Therefore, borrowing at the most minimal interest rate remains among essential means of effective state debt management.

At the time of economic growth, the national debt and GDP ratio regularly decreased in all the Baltic states. In Estonia this ratio diminished because of the stable economic growth and surplus in the budget. In the case of Latvia and Lithuania, the national debt and GDP ratio decreased because the national economies grew more than national debt. By the time of the recession, the situation changed fundamentally. In 2009 all of the Baltic states encountered economic decline; national GDPs decreased by more than 14 percent, meanwhile the budget income deficit rose. The resulted deficiencies were dealt with in various ways by all the states. Estonia was at its most fortunate situation because of the surplus in the national budget the gathered reserve was directed to partially cover up the demand for funds. The remaining demand was funded by state borrowing in finance markets. Therefore, Estonian national debt and GDP ratio grew from 2.7 to 7.2 percent in 2009. However, Estonia managed to maintain a rather balanced budget and not to exceed the limit of 3 percent. In 2008 Estonian budget deficit reached 3 percent, however by 2010 the national budget was excessive (by 0.1 percent of GDP) and the national debt and GDP ratio began to decrease. By the end of 2011 it was 6.1 percent only. In such of economical condition, there is no need to assert that the improvement of

²⁴Leviškauskaitė K., Rūškys G. (2003) Valstybės finansai: mokomoji knyga. Kaunas: VDU leidykla, 179 p

national debt management is relevant in Estonia. However, Latvia and Lithuania chose different scenarios.

At the current time, while indebtedness is a crucial problem for majority of state, Estonia has none. This particular state even since the end of 2007 has been minimizing its expenses, increasing taxes and saving excessive funds. Therefore the aftermath consequences of economic recession are not as perceptible for the citizens of Estonia – even though salary levels have dropped and unemployment rose, Estonia did not acquire any state debt, thus the funds, which Lithuania allocates towards debt maintenance, Estonia can inject into important financial sectors. This is a practical example, which proves that minimized state expenses can lead to subsequent growth of national economy. Thus in order to resolve the debt raised problems, the state has to reduce its public sector expenses, carry out structural reforms, promote economic productivity and to improve tax gathering.

By the time of the entrance into the EU Lithuania was characterized as the fastest growing economy compared to its neighbours Latvia and Estonia. Analyzing the data of pre – crisis period from 2004 till 2007, the Lithuanian real GDP rose by 8.2 percent on average yearly, while nominal GDP rose by 15.5 percent (the Department of Statistics of the Republic of Lithuania). The growth of GDP resulted in an increase of income gathering to the national budget, however, at the time the expenses of national governing sector were rising as well, thus, the deficit in national budget was formed from -0.4 percent of GDP in 2004 to -1.5 percent in 2007. At the time, the Lithuanian Government was carrying out an expansive fiscal policy which led to a state debt growth. On the other hand, in 2004 – 2007 the national debt was growing at a relatively slow rate for a nation that managed to borrow at a relatively low cost while experiencing a rapid economic growth (in 2005 the bond emission worth of 600 million euros was issued for only 3.75 percent interest rate). The situation changed in the second half of 2008, when the global financial recession struck (the growth rate of the real GDP lessened to 2.9 percent. In 2009 GDP declined even to 14.7 percent). At the beginning of 2009 the European Commission officially declared that the Lithuanian budget planning and implementation system was overly expensive, thus, there were not enough reserves to prepare the national economy for a change in a business cycle.

In 2010 the economy of Estonia had grown by a value of 3.1 percent, which was consequence of export. By the end of the year the inner demand became positive. The indexes of consumption and investments became positive by the fourth quarter, because successful integration of euro currency and strict fiscal policy have had a desired effect on economic growth. A particularly rapid growth of Estonian economy in 2011 was subsequently by

a larger than expected growth of export and the recovery of inner consumption. A strong foreign demand served as a stimuly for investments and workplace establishing, which consequently heightened the levels of salary, consumption and employment by 7 percent.. Despite deteriorating perspective of global economy, there was a growth of 2.7 percent by 2012 in Estonia, with an expected 4.0 percent by the end of 2013. These positive proceses in economy are the result of the investments in private and public sectors and household consumption, which was induced by a better situation in the labor market and lesser levels of inflation.

In 2008 Lithuanian public sector deficit exceeded the Maastricht criteria and reached 3.2 percent of the national GDP. At the time, the Lithuanian government not only was not able to stabilise the budget consolidation problems, but provoked the budget deficit (in 2009 public sector expenses exceeded its income by 9.2 percent), thus forcing to increase the national debt. The Government decided that there was no need to apply for help from international organizations and released an independent emission of euro bonds to the international markets. In the period from 2009 to 2010, Lithuania released 3.712 billion euro worth of bonds with 7.38 percent of average leverage interest rate to the international markets. In this case, Lithuania paid 2.016 billion euro worth of interest.²⁵

Having evaluated the applied derivative financial measures, the governmental sector debt rose by 5.0749 billion litas and by the end of 2012 amounted to 46.0364 billion litas or 40.7 percent of national GDP. Even though the governmental strict fiscal policy was carried out, the national debt growth was determined by a deficit in the governmental sector. In 2012 Lithuania borrowed slightly cheaper than in 2011. In 2012 Lithuanian Government paid 2.48 of yearly interest in the auctions of inner markets, compared to 2011, when the interest amounted to 2.96 percent and 3.53 percent in 2010. By the end of January, Lithuania released 400 million euro nominal worth of bonds to the international markets (the funds were transferred in February), which were meant to be repurchased in internal markets in 2018, and 600 million litas worth of bonds meant to be repurchased in August 2014. At the beginning of March Lithuania repurchased 1 billion euro worth of bonds. In March the state borrowed 799.2 million litas that were reborrowed to Ensurance Foundation of Deposits and Investments²⁶.

In 2014 Ministry of Finances will be borrowing funds by publishing government securities in the inner and foreign markets. It is estimated to

²⁵[http://www.finmin.lt/web/finmin/leidiniai/skola\[interactive\]](http://www.finmin.lt/web/finmin/leidiniai/skola[interactive]) [accessed on 21 09 2013]

²⁶[http://www.finmin.lt/finmin.lt/failai/skolinimosi_statistika/LRV_skolinimosi_grazinimo_statistika_2013_07_LT.pdf\[interactive\]](http://www.finmin.lt/finmin.lt/failai/skolinimosi_statistika/LRV_skolinimosi_grazinimo_statistika_2013_07_LT.pdf[interactive]) [accessed on 21 09 2013]

gather 4.2 billion litas from the inner, and 5.6 billion litas from the foreign markets.. There will be a lengthening of debt terms for government bonds in the inner market with period from 2 to 10 years, thus gathering the major portion of needed funds. Additionally a sum total of 600 million litas is foreseen to be borrowed from such foreign financial organizations as Nordic Investments bank, European Investments bank and the Council of Europe Development bank. Loans of these institutions finance long-term target value investment projects. A total of 2.3 billion litas are foreseen to cover up the expenses of state debt management (essentially as payments of debt interest) from the national budget in 2014.²⁷

Table 2 Lithuanian Government Borrowing and Debt in 2013

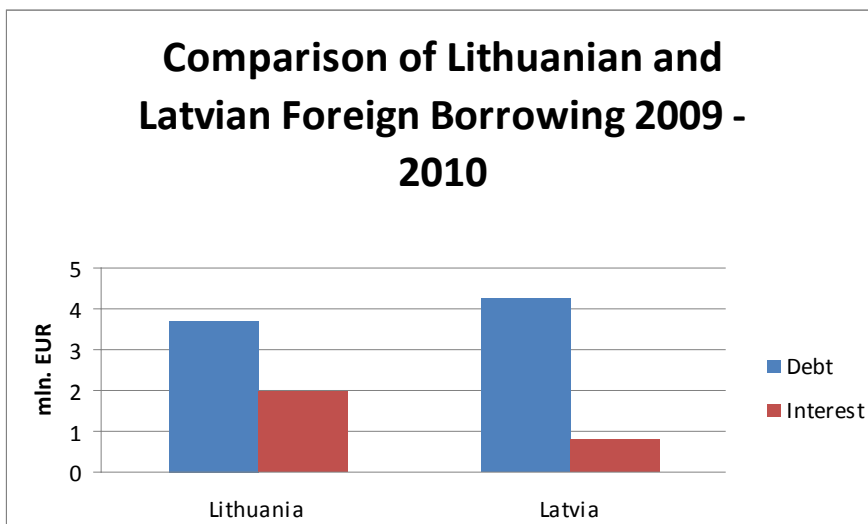
Government securities	January	February	March	April	May	June	July	2013 m.
Distributed by GS total	891,4	1.950,1	1.085,3	247,1	383,4	250,7	235,8	5.043,7
Redeemed GS total	589,1	557,1	3.247,4	255,1	62,6	469,3	34,4	5.215,2
Loans	January	February	March	April	May	June	July	2013 m.
Loans received from all	0,0	850,0	0,0	0,0	0,0	162,3	0,0	1.012,3
Repayment of loans to total	0,0	0,0	5,8	0,0	2,8	1,7	0,0	10,4
Total	January	February	March	April	May	June	July	2013 m.
Total borrowings	891,4	2.800,1	1.085,3	247,1	383,4	413,0	235,8	6.056,0
Total return	589,1	557,1	3.253,2	255,1	65,4	471,1	34,4	5.225,5

Source: www.finmin.lt/web/finmin/leidiniai/skola

In the case of Latvia, from its accession to the EU up to the middle of 2008, the nation went through a similar scenario as Lithuania: GDP went through a relatively rapid growth whilst an expansive fiscal policy was carried out that deficiated the national budget. Much like Lithuania, Latvia was not prepared for an alteration in business cycle conditions and faced the consequences of global financial crisis: a significant decrease in GDP and difficulties in balancing state budget. However, the government of Latvia chose different borrowing tactics than Lithuania. It was ruled out that borrowing in international markets was too expensive thus Latvia appealed to the IMF in 2008. The European Commission, the IMF and other international creditors approved of a loan package worth of 7.5 billion euro for 2009 – 2010 period. At that time Latvia used 4.288 billion euro from the loan package with an average leverage interest rate of 3.03 percent thus

²⁷<http://www.finmin.lt/web/finmin/leidiniai/skola>[interactive][accessed on 21 03 2014]

paying only 808 million euro.²⁸ Therefore, in the period of 2009 – 2010 at the very peak of the global financial crisis, Latvia borrowed more from the international creditors than Lithuania did by 576 million euro but 2.4 times cheaper. Consequently, Latvia paid 2.5 times less interest for drawn foreign capital compared to Lithuania in the same time period. (see Figure4)



Source: Information prepared in accordance with the data provided by Lithuanian Ministry of Finance and Latvian Ministry of Finance

Figure 4: Comparison of Lithuanian and Latvian Foreign Borrowing 2009-2010

In 2011 the national debt and GDP ratio rose in Lithuania. At the same time in Latvia the index decreased by 2.3 percent (down to 42.2 percent), because Latvian national economy improved and grew more than the national debt. Meanwhile, the national debt in Lithuania increased by 0.6 percent – up to 38.5 percent in total. Lithuanian national debt rose by 2 billion litas because of the demand to pay back the deposits of “Snoras” bank. Although, in Lithuania the change in national debt and GDP ratio was inferior to Latvia the ratio was superior in total values (38.5 percent in Lithuania and 42.2 percent in Latvia). Both countries had much better GDP and national debt ratios than 60 percent²⁹ which is determined in Maastricht Treaty.

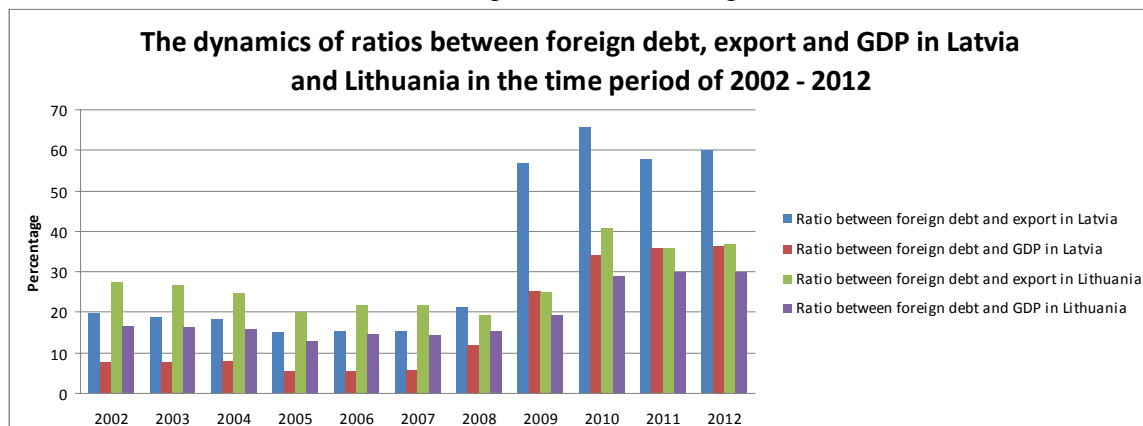
It is considered that borrowing with low interest rate is a key to an effective debt management. An analysis shows that according to this criterion Latvia managed its national debt better than Lithuania as national debt

²⁸Minister of Finance. Latvian Central Government Debt Management Strategy 2012
 <http://www.kase.gov.lv/texts_files/Debt_Management_Strategy_2012.pdf>.[interactive]
 e][accessed on 24 09 2013]

²⁹<http://www.finmin.lt/web/finmin/leidiniai/skola>[interactive][accessed on 21 09 2013]

management is a constituent part of general economic policy. The Latvian case shows that not only by the IMF financially aided nations did not lose, but gained trust of their investors concerned with national governments capability to handle fiscal problems with the help of the IMF supervision and proposed means to restrain the national budget. Thus, in the time period of 2011 – 2012 Latvia applied for a second loan worth of 2.1 billion euro from the IMF with a 4.15 percent average interest rate while Lithuania borrowed 2.8 billion euro from international markets with a 5.73 percent average interest rate.³⁰

The greatest drawback of borrowing in the international markets is that the interest paid for a loan accrue to foreign creditors, thus, decreasing the amount of internal national funds. This could be compared to a capital import which has to be counterbalanced by export. According to the data provided by the Eurostat, the export of Latvia and Lithuania is much larger than their national debts to foreign markets. (see fig.5)



Source: Information prepared in accordance with the data provided by Eurostat

Figure 5: Dynamics of foreign debt, export and GDP ratios in Latvia and Lithuania in the time period of 2002 – 2012

Until 2007 Latvian foreign debt and export ratio in Latvia was superior to Lithuanian. In the time of global financial decline the situation changed fundamentally. Because of borrowing from foreign creditors such as the IMF and the EU Latvian foreign debt and export ratio increased markedly. The ratio reached 66 percent in 2010. In 2011 the ratio was reduced to 58 percent due to increasing export. The Lithuanian ratio markedly increased in 2009, when borrowing from international markets took place

³⁰Minister of Finance. Latvian Central Government Debt Management Strategy 2012 <http://www.kase.gov.lv/texts_files/Debt_Management_Strategy_2012.pdf>.[interactive][accessed on 24 09 2013]

and the national export shrunk by 25 percent. The ratio between foreign debt and export peaked at 41 percent in 2010. Because of an increase in export the ratio reduced to 36 percent in 2011. The graphs in figure 2 represent the fact that Lithuania managed to maintain a better foreign debt and export ratio at the start of the global financial crisis. The main cause was a more rapidly growing export as compared to Latvian. According to the data provided by the Eurostat, there was on average a 30 percent yearly growth in Lithuanian export, whereas the index reached 20 percent³¹ in Latvia. The change in foreign debt and GDP ratio was similar to the change in foreign debt and export ratio until 2008. Starting from 2009 foreign debt and GDP ratio began increasing in both Latvia and Lithuania. Such an alteration was caused by the fact that the greatest part of required funds was borrowed in international markets. Furthermore, in 2009 it was noticed a decrease in GDP which caused an increase in foreign debt and GDP ratio. In 2011 the growth of foreign debt and GDP ratio was minimal and totaled to 1.6 percentage points in Lithuania and 0.9 in Latvia. That year, the ratio between foreign debt and GDP peaked at 29.9 percent in Lithuania and 36 percent in Latvia. On the basis of current tendencies, if the internal market situation does not change substantially, foreign debt and GDP ratio should continue growing.

Conclusion

1. The main reason why Lithuania's state debt is continually increasing is recessive processes in global economy first surfaced in 2008, which had a negative effect on open Lithuanian economy. Therefore rapidly decreased state GDP lessened the levels of tax income and served as a reason of fiscal deficit growth in the governmental sector. It is because of this crisis the cost of borrowing became more expensive and the demand for it was satisfied mainly by applying short-term borrowing means in inner market, which meant to balance the flow of state's monetary resources.
2. In order to pursue an effective state debt management, the managing institutions must consider factors such as: 1) risks levels of the market, liquidity and credit; 2) the structure and term of debt; 3) the strategy of debt management.
3. State debt can be perceived as a sum of liabilities taken in the past which are planned to be carried out in the future, which influences policies of

³¹Eurostat duomenų bazė. Požymiai: Lietuvos ir Latvijos eksportas, importas, užsienio skola, BVP, biudžeto pajamos, išlaidos, valstybės skola, ilgalaikės palūkanų normos 2002 - 2011, [http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database\[interactive\]](http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database[interactive]) [accessed on 21 09 2013]

economy and governing..In order to better the national rates of borrowing, an improvement of debt management quality is needed.

4. National debt of Latvia is growing because of deep recession.A powerful influence in borrowing processes of Latvian economy is implemented by a problem that emerged in past – the deficite in the current account. It is considered that the only resort out of such circumstances is an integration of the currency of euro, which should lessen the cost of borrowing in markets and improve investors trust.

5. Strict fiscal policy retains it's position as one the pillars of Estonian economy.

6. The arguments of Lithuanian politicians not to borrow from the IMF are economically groundless. The analysis of fiscal policies carried out in 2009 – 2010 and a review of the result of borrowing have shown that not only was Latvia borrowing markedly cheaper than Lithuania, but maintained even bigger trust of investors because of responsibly implemented policies. Moreover, this argument could become an important factor competing for foreign investment.

7. The main index of state debt status is the ratio between state debt and GDP. In order to make the economic situation sustainable, the national budget should be balanced or at least its deficit should remain smaller than economic growth.

8. The most significant increase in state debt was noticed at the start of the financial decline. From the end of 2008 until the end of 2011 state debt grew more than twice – from 15.6 percent of GDP to 37.9 percent of GDP, meanwhile by the end of 2011 foreign debt took 74 percent portion of the whole debt.

9. The biggest foreign debt and GDP ratio was registered in 2011 with 29.9 percent in Lithuania and 36 percent in Latvia.

10. In the time period of 2011 – 2012 Lithuanian inner debt portion in the national debt was one of the smallest in the EU. By the portion of citizen and non – financial companies invested funds and by the portion of national stocks issued in local market in the whole national debt, Lithuania took forth and seventh place in the bottom of the list of the analysed countries;

11. The portion of debt management expenses has grown that is received by foreign creditors. Interest is paid to foreign creditors for loans. Therefore, it reduces the amount of funds in the state.

By implementing measures to expand the internal market there could be up to 4.8 billion litas more for borrowing. This could increase the portion of internal debt by 12 percentage points, thus, reaching a total of 38 percent of national debt. In 2012 Lithuania borrowed slightly cheaper than it did in 2011. In 2012 the government paid an average of 2.48 percent of yearly

interest in national stock auctions (in comparison to 2.96 percent in 2011 and 3.53 in 2010);

12. In order to borrow effectively in foreign markets, it is necessary to regularly analyse them because the situation in foreign markets remains dynamic. Markets which were favourable a year ago now could have given up their advantages. Besides, there could appear cheaper alternatives, such as borrowing in other currencies or financial aid from the IMF.

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