
FINANCIAL CRISIS AND INTERNATIONAL INDEBTEDNESS

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Abstract: We are witnesses of one of the greatest financial crisis in the human history. Today we have a clear picture, figures, and greatest losers. There is not an economic activity that has not been affected by this crisis. Nevertheless, it is about a crisis of a whole system and doctrine. Whatever the final outcome is there will be deep impact on the financial system.

The experience shows that the financial crisis never appears as an isolated crisis, but it appears typically as a sector crisis that additionally spreads in the other sectors.

The economists point out that the nucleus of the world financial crisis is the so called mortgage loans. But the financial crisis started a lot earlier with the cancellation of the direct international convertibility of the United States dollar to gold (1971) and since then money emission has not been limited by anything. Thus, the dollar became a world currency, and the USA gained a status of a hegemonic force that adopted the concept of fully free market and neoliberalism with the thesis that if every financial and economic problem appeared it would be solved with an absolutely free market.

Holding on to this concept in the USA, every control and inspection regarding the behavior of the market was abolished and it was transferred to all other countries directly or indirectly through IMF and World Bank. Since the profit is higher in the financial rather than the real sector, the capital moves from the real to the financial sector. The financial sector starts to grow uncontrollably. The traditional conservative banking transforms, new institutions emerge, new financial products are created. Due to the above, the financial sector develops independently and incomparably faster than the real economy.

The growth of the financial sector and its globalization is also provided by the dynamic deregulation, the development of hard technologies – informatics and telecommunications, as well as the development of soft technologies – the financial products are getting more numerous. The financial market has become global, gigantic financial subjects, banks and others have developed and become too big to fail. As a result of the international actions for saving the financial system after September 2008 and the collapse of LIMAN BROTHERS, the huge debts that were accumulated by the bank and the private sector, were transferred to the public sector. The debts of the governments have experienced real explosion worldwide, not because of the multibillion operations for saving the banks and the corporations but because of the fall of the tax income and the increase of the public consumption that lead to global crisis.

Somewhere between the interests of the banks, blinded by the desire for easy profits, and the governments of the developing countries, led by the idea of overcoming the gap between the poverty and the opulence, the basic rules of credit analysis were neglected. The purpose of this euphoric atmosphere was supported by the international financial institutions that considered that the extensive indebtedness could stimulate the economic development.

Keywords foreign indebtedness, indebtedness ,debts, international market, monetary system , financial institutions, international liquidity

INTERNATIONAL INDEBTEDNESS

Is any economy in a certain phase of its development too indebted? Is there a risk of liquidity crisis and crisis of fulfilling the international obligations orderly? What is the price that has to be paid in the development because of drain of income and foreign currencies, for external obligations? All of these questions arise, because on the one hand most of the economists claim that a lot of countries are under the threat of debt collapse, and on the other hand the credit conditions are getting worse in parallel with the extension of crisis in the western developed economies.

Using foreign capital almost in every national economy affects the dynamics of the economic growth, changing the economic structure of the national economy, the state of the balance of payments, the level of international liquidity of the national economy, the level of stability, the level of indebtedness and also the level of economic, financial and political dependence of the national economy.

Every national economy tends to lead a policy of optimal foreign indebtedness, although it is different for every country, there is no established legality. When the optimal limit of indebtedness is determined the following factors must be taken into account: .

- Stability and sustainability of the export growth;

- Achieved level of import dependence and a possibility of decreasing the import, without any risk of increasing the difficulties in the normal functioning of the economy;
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- Structure of the debts regarding the terms, the interest forms of the funds and the dynamics of debt maturity;
- Possibility for new indebtedness;
- Possibility of short-term debt conversion to a long-term debt and favorable interest rate;
- Achieving new debts easily or harder depending on the existing indebtedness of the economy, its external liquidity and the trends of the world financial market.
- Political situation in the country, in the world and so on.

Starting from the fact that the macroeconomic imbalance in the national economy can be determined by the mistakes of conceiving and implementing the macroeconomic policy, and also by external i. e. exogenous changes in the conditions of the world market, the determinants of the indebtedness of the national economy can be categorized into two groups: a) internal or endogenous and b) external or exogenous.

The endogenous determinants are the following:

- Excessive personal, general and investment consumption;
- Increasing the investments beyond the level of domestic savings;
- Conduct of policy of negative real interest rates; rapid investments in the country discourage domestic saving;
- Policy of formation and maintaining an overstated foreign exchange of the national currency;
- Growth of the inflation rate in the country;
- The increased import of equipment always stimulates an increase of the export dependence of the production structure of the national economy;
- Disregard the axiom: rational foreign indebtedness of the national economy..

In the group of external (exogenous) determinants are mostly the following:

- The growth of the demand of the international capital market results in worsening the conditions of using foreign funds for investing in the national economy. If the foreign funds are needed for decreasing the hunger for funds, in this case there are unfavorable terms for using the financial investments.
- The formation and the fluctuation of the interests rates on the international capital market, especially the formation of the interbank interest rate in London (LIBOR), regarding dollars and (EURIBOR) regarding euros.
- Deterioration of the terms of the exchange on the international market of goods and services affects the production capacity of the users of the foreign funds, and it also affects their appearance on the international market and the ability to return the loans.

The problem of the external indebtedness of the developing countries is not possible to be solved outside the international monetary and financial system framework. The monetary system that was defined by Brentwood arrangement and has been corrected a couple of times with some partial reforms is not a consistent frame for solving many problems connected to international payments. Logically, it is a result of radical changes in the structure of the international monetary and financial relations that are a result of a multiple entanglement of the monetary and financial institutions.

In the contemporary academic and official literature there is a striking distinction between the monetary and the financial system. The international monetary system is defined as a collection of arrangements that specify the rights and the responsibilities of the government, regulating the relations between them and their national monetary systems. Simultaneously, the financial system is widely defined and also includes the private subjects such as the banks and the markets which they operate on. The situation today is completely changed, because the monetary authorities are not just regulators of the operations of the financial markets, but also active participants and the banks are no longer seen as regulation objects, but as equal participants in the regulation of monetary and financial relations. Thus, in an organized monetary system the autonomous competences of the monetary authorities are reduced and because of the significant effect of the markets, the cyclic and asymmetric oscillations are more frequent.

However, despite the instability and the possible risks of loss of the system of flexible exchange rates and the relative autonomy in the determination of the level of interest rates as well as the official mechanisms that implicitly mean that the monetary policy is independent, this is still a system that mainly focuses on the existing distribution of the economic forces or it is just a suitable system for the most developed economies.

Another gap in the structure of the monetary financial system that prevents acceptable solution of the problem of external indebtedness is inadequate amount of international liquidity. It is about the total deficit of liquid assets in the international payments, if their adequateness is measured with the proportion of the level of the official reserves to the extent of the world trade.

The proportion of the official reserves to the amount of import is way too unfavorable for the developing countries and if the indicator of the liquidity is corrected and treated as a proportion of reserve assets to the amount of the import that has been increased because of the burden of payment of the accumulated debt, the situation of asymmetric distribution of the liquid assets in the world financial system is even clearer.

When it comes to the indebtedness of the countries two questions arise: the reasons for the indebtedness and the danger of over-indebtedness. If it is about external indebtedness of one national economy, it is a result of the imbalance between aggregate demand and aggregate supply of the economy. The optimal level and the structure of the external debt (and with it the absorption of the foreign accumulation in the domestic production is carried out) is a result of the optimal proportion of the national consumption to the production (GDP), but also the other macro-aggregates in the economy.

The external debt and the behavior of the indebtedness is a result of the quality, the structure and the stability of the national economy. Thus, the amount and the structure of the external debt provides the additional accumulation from abroad to be seen as an active factor of the economic development, which not just temporarily fills the gap of the domestic investments and the saving, but also stimulates the efficiency and the social profitability of the investments, using internal accumulation especially in the phases when the price of the capital on the world market is extremely high. The optimal upper limit of indebtedness of an economy is reached (at least theoretically) in case of 25% of the foreign influx must be arranged in advance for payment of the foreign obligation during the year.

So far the practice of foreign indebtedness shows the following finding: the burden of indebtedness grows if the proportion of the deficit in the balance of resources to the debt is corrected to the proportion of the surplus of the transfer to the debt and it is increased by the average interest rate of the loans and it is higher than the import growth rate. If there is stability in the balance of resources and current transfers, the payment rate increases and if the growth rate of the import is lower than the average interest rate of the debts. Thus, the growth rate of the import must be higher than the interest rates of the debts if we want to avoid the problem of the payment of the debts, and at the same time the problem of international liquidity. If this is not followed, there is an inability of debt payment, which leads to debt crisis in certain debtor countries thereby in the whole world.

If we want to understand the real situation of the debt burden, the possibilities for servicing, the possibility for new indebtedness, encouraging domestic investments and production of foreign capital and so on, it is necessary to follow the real matrix of all the aggregates that decisively affect the optimal and maximal level of international indebtedness of the economy and the state, without starting debt crisis.

Does this strategy exist? The indebtedness is a turbulent process that is in the spirit of neoliberalism and the fast and great liberalization of the international trade, even the capital transactions. It is followed by an overestimated exchange rate, uncompetitive domestic production of the world market, with a credit mechanism that stimulates the demand of import goods, without stimulating the export and the developing monetary and fiscal policy.

The overestimated exchange rate significantly increases the gross domestic (inflationary) product expressed in dollars or euros, but the foreign debts are not decreasing even expressed in those currencies, thus the participating debt and debt obligation in GDP diminishes artificially.

The problem is that debt obligations gradually grow so the increase of the domestic product is not enough to service the interest rates and the debt payment. Debt obligations fully absorb the whole increase of the national product.

It is important that the growth of the economy is sustainable in the long term, and the growth is sustained if it is achieved with small external and internal imbalances. The national economy accomplishes high growth rates of the GDP and even faster growth of the income and the consumption of the citizens, and at the same time there is a high deficit in the current balance of payment and high fiscal deficit. This model of growth means that a large number of the investments and the consumption are financed by the foreign loans or foreign direct investments. The problems get even bigger if the foreign loans are used for financing the current consumption and most of the foreign investments go into the sector of non-tradable goods.

High deficit in the current balance of payment is a risk not just for the growth of the country but also for the maintenance of its public finances. The high deficit can be financed as long as there is trust in the foreign investments, and when that trust will disappear for any reason then there is an enforced decreasing of the foreign deficit, and a decrease of the private consumption, investments and GDP. The decrease of GDP automatically leads to a decrease of the tax revenue and an increase of the fiscal deficit and the national debt.

It is important that the foreign exchange of the national currency is synchronized with the other macroeconomic variables such as productivity and salaries. If the foreign exchange is not synchronized with the productivity and the payments it is difficult for the country to achieve high growth with the external deficit, whose financing depends on the world capital market.

The countries that have a flexible foreign exchange, can execute the synchronization with the policy of income, control over the domestic demand and the policy of the foreign exchange.

If the country has a high fiscal deficit it is necessary to start a consolidation as soon as possible, and the consolidation measures need to be strong enough in order to decrease the deficit to a sustainable level for a short period of time. Taking consolidation measures timely is very important when it comes to small economies that have a low credit rating, thus they do not have the potential for implementation of fiscal stimuli that are used for increasing the economy growth through increased national consumption.

It is obviously about a sequence of indicators that every economy must follow in order to lead a policy of optimal external indebtedness and international liquidity –to prevent debt crisis i.e. international insolvency. On the basis of those indicators the real indebtedness and the debt burden could be seen for the period of one year. It is about a complex dynamic occurrence that depends on many factors.

The amount of debt and its proportion to the gross domestic product does not reveal anything about the following important elements: short-term and long-term debt; the dynamics of debt maturity and the growth of national product, the level of interest rates as fixed obligations; the system of using the debts (production, non-production) and their efficiency in the economy and creating national product; the proportion of the stand-ready obligations after the debt and the growth of the national product (the amount of available foreign-exchange reserves); the amount and the deficit of the balance of trade and the balance of payment; the dynamics of the economic growth and the dynamics of the foreign debt, the possibility of a write-off of a part of the debt, the fluctuation of the capital on the world market and so on.

The proportion of the debt to the GDP does not have a great significance as an indicator for indebtedness, but the annual economy growth and the raise of the debt and the stand-ready obligations of the debt during the year indicate if the general development power of the economy is getting strong or weak or it is headed towards indebtedness.

No one could predict the direction of the crisis. But definitely there will be consequences and the only question is how serious they will be.

The regional banking sector suffers a great loss, there are more and more debts, the indebtedness is growing, and there are no funds for payment of the debts.

CONCLUSION

One of the major problems that the developing world is facing today is the high external debt.

Debt burden is a major obstacle in securing capital and future economic growth as well as main preoccupation in the field of international finances because many developing countries simply cannot pay their debts without the help from the developed countries.

The reasons for the underdevelopment of the developing countries are numerous. It is a reality that they differentiate with respect to structure and international economic limits that they are facing.

The theory and the empiric research point out that those that bring economic decisions need to alertly follow the structure of the debt and the proportion of the short-term obligations to liquid assets. With an extension of the average debt maturity the countries can decrease its crisis vulnerability. On the other hand the limits of the short-term debts are not a full remedy because in some cases the governments and the private users can have every reason to accept short-term debts.

In the debtor countries domestic policy and the structural reforms are very important in securing instant effect on the domestic policies in the overcoming the problems and the limitations set by the international surrounding.

Nevertheless, the flexibility of the domestic policy and the reaction of the offer to a large extend depends on diversification of the production structure, the previous accumulation of physical and human capital, the level of institutional and technological development, the access to markets, credits and investments.

The debt crisis is far from its end, but still it does not have a high priority to be put on the agenda. Although numerous actions have been taken for developing a strategy, the debt issue is not overcome and a lot of developing countries are still facing difficulties with the servicing of the obligations, renewing the economic growth and a sustainable balance of payment.

The academic circles and the international financial institutions have paid a lot of attention and effort for solving the problem of the external debts and the debt sustainability, but this issue remains the greatest burden for this group of countries, threatening the favorable outcome for economic growth.

The governments of the developing countries, together with the private sector, the civil associations and the donators work on creating the strategy for decreasing poverty, but there is a lack of finances for an ambitiously enough strategy to avoid the traps of poverty and to accomplish the millennium's developing goals.

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