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The Importance of Public Debt in the Economy and Assessing its Sustainability - The Case of the Republic of North Macedonia

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ABSTRACT

The issue of public finance stability is one of the issues that are made many analyzes if high budget deficits are a cause or not. Also, the stability of state debt is presented as a political and economic challenge in the global sphere. Focuses on the economic, social impacts, political, and current reflections of borrowing in the context of public debt theory, the transformation in the external debt structure in the globalization process nowadays is emphasized. Initially external assistance and debts taken by developing countries as development financing have been used as a means to eliminate the stagnation by the developed countries in their economies.

Public debt represents the accumulated value of loans that the state has taken to finance past deficits. Public debt is a burden on the economy, because it must also return reducing national incomes. The level of public debt directly influencing public investment (G) primarily affects the level of public and private investment (I), the level of employment, the level of consumption in an economy (C) and the level of production affecting the level of imports (I) and exports (X).

KEYWORDS: *deficits, debt sustainability, political and economic challenge, the accumulated value of the loans, bonds, investment, consumption*

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INTRODUCTION

Governments around the world are facing budget deficits because of the large expenditures they make and the low income they have. There are ways for governments to raise revenues by raising taxes, printing more money, lending, and using earlier budget surpluses. In cases where the government decides to borrow rather to impose additional tax measures to finance deficits, it creates the obligation otherwise known as public debt.

The government has various alternatives to borrow with the purpose financing the fiscal deficit. In one hand, the government has the right to borrow loans from central bank which deals with printing and issuing money. Other ways that can take borrow is from commercial banks, from the domestic non-banking sector and from outside sources. Each of these methods has its own implications for various aspects of the economy.

Economic growth is the growth of the average incomes of an economy that is measured by various factors but the most important can be calculated Gross Domestic Product (GDP). But why do governments need to borrow? According to various analyzes this may be the case when the government wants to adopt or update the technology and other factors that affect the growth of employment opportunities and the increase of local productivity.

Sovereign debt has received much attention as an important component of a country's macroeconomic and financial framework. Indeed, past crises have been caused by the debt crisis. Recent attention with sovereign risk by policymakers and financial markets comes from realizing how debt management significantly impacts the sustainability and solvency of the overall public sector balance sheet. Debt management is also perceived as an important factor that underpins sovereign credibility and reputation and also conditions the stability of debt capital markets and financial institutions that hold public debt.

This paper investigates the relationship between the level and management of public debt and financial stability, and explains the channels through which these two are interrelated. It should be considered that these implications for debt management need to be carefully analyzed by debt managers and policymakers in terms of their impact on government balance sheets, macroeconomic developments and the financial system

LITERATURE REVIEW

Governments were not always relied on borrowing to carry out public functions or to finance important projects, even

according to Sokolov et.al[1] governments attitude towards using public borrowing has gone through several stages since refusing to use public debt and labeling it as a curse and punishment until the full justification and approval of this phenomenon.

This decision is also presented by various authors where Hume in 1777[2], said that the State must extinguish public credit or in the other way public credit would extinguish the state. Whereas, Smith (1776)[3] argued in his book that financing of government with taxes comes with a cost primarily to reduce current consumption, while financing by public debt brings changes in the level of savings and private equity. But what are the variables that affect in the size of the Public Debt and what effects in lowering its level? Depending on the stage of economic development, the main variables affecting in the size of the public debt are economic growth and the size of public expenses.

Another element that affects in the size of public debt are public expanses, when are undertaken in the function of education, but this relationshipis mostly considered for countries with high incomes because it is thought that they devote much more importance to this part.

In the other case, we can say that the unemployment rate may cause to decrease the level of public debt that the government can afford by limiting the government's ability to generate high levels of employment income.[4]

METHODOLOGY

The methodology of this paper is related with the public debt and GDP of the country. The model of this research has been modified to assess the impact of public debt on GDP at the state level, as well as to assess the interdependence between public debt and GDP. To explain this relation related with these two variables will be applied the estimation of the coefficient of determination R^2, as well as the use of tests to evaluate the significance of the variables.

The data presented in the study are data published by INSTAT about impact of public debt on GDP from 2008-2017. Public debt of the Republic of North Macedonia at the end of 2017 was 3,958.5 million euro, ie 39.3% in relation to GDP. Government external debt at the end of 2017 reached to 2,376.8 million euro, compared to 2016 it decreased to 69.8 million euro, while government domestic debt amounted to 1,581.7 millioneuro, an increase of 176.8 million euro compared to the previous year.

Even the level of guaranteed public debt that represents public and private sector debt obligations, whose service is guaranteed by the agreement of public sector entities under the borrowing procedure regulatory law, has increased significantly for the period 2014 -2017 and its level is estimated at about 8.2 percent to GDP.

However, as this public debt represents merely a "potential public debt" that may not result in future government costs, the table below provides an estimate of the level of total public debt in the country without the guaranteed public debt. As you can see a guaranteed public debt that can be served by all the beneficiary units significantly reduces the level of public debt stock in the country.

Indicators in% to GDP	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Trend
Stock public debt		71,7	76,4	78,3	76,7	76,7	73,2	78,2	83,2	83,2	100 50 0 / 1 2 3 4 5 6 7 8 9 10 / Stoku BP
Guaranteed public debt	2,5	2,6	3	4,3	4,7	6,3	7,7	8,5	8,8	8,2	
Public debt without the guaranteed public debt	20,5	23,6	24,1	27,7	33,7	34	38,1	38,1	39,9	40	50 40 30 20 10 0 / 1 2 3 4 5 6 7 8 9 10

[1] [1]Public borrowing divided into 5 stages: 1. As a curse, 2. Using public debt only in emergencies, 3. Developing multiple theories on perceptions of the advantages and disadvantages of PB, 4. Justifying public debt, and 5. Settling of PB management rules nowadays.
[2]https://www.researchgate.net/publication/254392590_Government_Debt_and_David_Hume
[3]https://www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf
[4]https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1237.pdf

The level of public debt and the level of guaranteed debt in percentage to GDP

So, in formulating the hypotheses, we can say that there is an inverse relationship between public debt and GDP. In the data collection we show that public debt is presented as an independent variable affecting on GDP. With the mathematical model $y = a + bx$, $y = \beta o + \beta 1x$ as i.e. GDP (y) = $\beta o + \beta 1$ public debt and with the formulation of the econometric model $y = \beta o + \beta 1x + u$.

In testing the results we can say that analyzing the sustainability of public debt in a country is an integral part of studying its dynamics over a period of several years, starting from the most important events that have accompanied and left a mark on the country's economy.

SUMMARY OUTPUT

Regression Statistics	
Multiple F	0,209594
R Square	0,04393
Adjusted I	-0,07558
Standard E	3,19658
Observati	10

ANOVA

	df	*SS*	*MS*	*F*	*gnificance F*
Regressio	1	3,756033	3,756033	0,367585	0,561129
Residual	8	81,74497	10,21812		
Total	9	85,501			

	Coefficient	*andard Err*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*ower 95,0%*	*pper 95,0%*
Intercept	3,461847	1,06756	3,242767	0,011829	1,00005	5,923643	1,00005	5,923643
X Variable	0,002222	0,003665	0,606288	0,561129	-0,00623	0,010675	-0,00623	0,010675

The equation that gives the relation between the values of public debt and GDP is:
y = 3.461 + 0.0022. Examining the data resulting from linear regression, the coefficient of determination, R^2 0.04393 explains the 20% distribution of observations.

The obtained equation is valid, statistical probability 0.561129.

Regression based on secondary data is 3.75. With positive coefficient 3.461 and standard error 1.067.

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