

The Importance of the Capital Market in the Financing of Public Debt

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The reasons for the emergence of public debt, its increase or decrease in size and amount are inextricably linked with the economic policy of each country, the scope and dynamics of the reforms being carried out. There are several reasons why the demand for external debt in our country has increased in recent years. The most important of them are issues of economic security, disparity between economic power and social demands, increase in the budget deficit as a result of improper use of financial resources, emergency situations, in particular, the coronavirus pandemic.

Today, as of January 1, 2023, the balance of state debt is 29.2 billion dollars, and during 2022 it has decreased to 36.4% compared to the gross domestic product (GDP). Although the public debt increased by 2.9 billion dollars during the year, the ratio of public debt to GDP decreased due to the rapid growth of the gross domestic product in dollar terms by 11.1 billion dollars.

The balance of state external debt increased by 2.4 billion dollars in 2022 and reached 25.9 billion dollars as of January 1, 2023, or 32.25 percent of GDP. Of this, the foreign debt raised on behalf of Uzbekistan is 19.8 billion dollars or 76.5% of the state's foreign debt, the foreign debt raised under the guarantee of Uzbekistan is 6.1 billion dollars or 23.5% of the state's foreign debt¹.

Despite the fact that the foreign debt is one of the most widely used financial instruments in world practice, there is a need to objectively consider the risks of using it to fill the state budget deficit. Especially for developing countries, a sharp increase in the amount of foreign debt can cause or increase economic and political dependence on international financial structures. In addition, the continued increase in the amount of debt will cause an increase in the budget burden of the state in paying off debts. Also, there is a great possibility that negative situations will occur in the economy as a result of attracting corporate debt from the domestic and foreign markets and spending it on ineffective projects, or as a result of a sharp change in the macroeconomic situation, i.e. inflation rate, economic growth rate, and national currency exchange rates. The main reason why the share of domestic debts in the composition of state debts is relatively decreasing year by year is related to the level of development of the capital market and its current state. Due to the insufficient improvement of the capital market, the need for securities in financing the deficit in the state budget is determined at a relatively low level based on the domestic demand in the financial market. One of the urgent issues of today is to conduct the stock market in accordance with the requirements of the time, which is important for the economic development of the country. Increasing the share of domestic debt by issuing a large amount of government securities is not an issue that can be solved quickly. The Ministry of Finance, in cooperation with the International Monetary Fund, the World Bank and the U.S. Department of Treasury, is working on diversification of the state debt portfolio.

¹ <https://www.gazeta.uz/oz/2023/08/17/debt/>

Of course, the wide use of internal financing sources and the development of the state securities market will allow to reduce currency risks. For this purpose, the wide use of opportunities to attract local and foreign investors by placing state and corporate securities in the domestic financial markets shows the need for rapid improvement of the capital market in Uzbekistan. State debt arises as a result of the implementation of debt relations by states. Debt obligations of the government to individuals and legal entities, foreign states, international organizations and other subjects of international law are called public debt. In the Law of the Republic of Uzbekistan "On the Budget System", the state debt is defined as "the sum of the obligations of the Republic of Uzbekistan arising as a result of attracting internal and foreign funds by the state.". A number of developed and rapidly developing countries have seen a sharp increase not only in the public debt, but also in the debt of commercial banks and the corporate sector, which caused serious problems in the economy during the global financial crisis. The experience of these countries shows the need for each country to have its own national strategy for the continuous control of the level of indebtedness, the prevention of excessive debts, and the effective management of external and internal debts. Taking into account that foreign debt remains an effective alternative way of state support for structural reforms in the conditions of the formation of the domestic capital market in Uzbekistan, it is appropriate to take measures to quickly use the financial mechanisms of the country's investment and debt market. It is an important task to effectively attract the funds of the population to the economy.

State securities are an integral part of the financial system of any developing country based on the requirements of the market economy, which has its own functional, organizational and legal structure. Government securities and the working mechanisms of this market are a constantly evolving system, which is being studied and improved by researchers and practitioners working in financial market structures. Issuance of government securities is one of the most economically effective ways to cover the budget deficit. The Law of the Republic of Uzbekistan "On the Securities Market" provides the following definition: government securities- treasury obligations of the Republic of Uzbekistan and issued by the body authorized by the Cabinet of Ministers of the Republic of Uzbekistan, bonds of the Central Bank of the Republic of Uzbekistan. According to the decision of the Cabinet of Ministers of the Republic of Uzbekistan dated December 14, 2018 No. 1016 "On measures to organize the circulation of State Treasury obligations and bonds of the Republic of Uzbekistan", the state treasury obligations of the Republic of Uzbekistan and the rules of the procedure for issuing bonds (government securities) have been established. In order to effectively ensure the implementation of this decision, on December 26-28, 2018, the Central Bank, together with the Ministry of Finance, issued 1 million sums at the currency exchange of the Republic of Uzbekistan for a period of six months, one year, and three years. Auctions were held for the placement of 600,000 pieces of state securities with a nominal value of 592.1 billion sums. State securities of the Republic of Uzbekistan include:

1. Treasury obligations and bonds with coupons and discounts issued by the Ministry of Finance of the Republic of Uzbekistan in undocumented form and placed among commercial banks and other legal entities among residents of the Republic of Uzbekistan;
2. Bonds of the Central Bank of the Republic of Uzbekistan issued in undocumented form and placed between commercial banks. Placement of government securities is conducted in the form of a simple auction. The circulation of government securities is carried out in auctions in the style of a continuous two-way auction. Organization and conduct of trading in state securities "Rules for trading in state securities on the currency exchange of the Republic of Uzbekistan" and "Trading in bonds of the Central Bank of the Republic of Uzbekistan on the currency exchange of the Republic of Uzbekistan are regulated by "transfer rules". All operations on the circulation of state securities are carried out through dealers authorized to carry out operations on the basis of agreements concluded with the Central Bank and the currency exchange of the Republic of Uzbekistan.

The total amount of state securities issued on behalf of the Republic of Uzbekistan in 64 electronic auctions held in January-December 2021 is 4.9 trillion sums, of which the net volume

of state securities issued to finance the state budget deficit amounted to 4.1 trillion sums. According to the schedule of state securities auctions during 2021, 4.9 trillion sums of state securities were issued on behalf of the Republic of Uzbekistan by holding 64 electronic auctions (including 4.1 trillion sums to finance the state budget deficit). Among them: state debt with a circulation period of up to 1 year - 3.8 trillion sums; State debt with a circulation period of 1-5 years - 1.0 trillion sums. Issuance of medium and long-term government securities serves as a benchmark for attracting funds by issuing low-risk instruments in national currency, creates a basis for diversification of financial instruments and attracting new participants (insurance companies, etc.) to the financial market. During 2021, 2.1 trillion sums with a circulation period of up to 1 year, 2.0 trillion sums with a circulation period of 1 and 3 years were extinguished. As a result, as of January 1, 2022, the debt amounted to 4.7 trillion sums. The Central Bank of the country performs the function of the chief representative for servicing the internal debts of the state. In each bond issue, all single and aggregate certificates must be delivered to the depository for safekeeping and accounting by the Ministry of Finance. Today, the purpose of issuing sovereign bonds is not only to support the economic and social spheres, but also to increase the opportunities of corporate structures in the country to use foreign capital and to support the growth of the bond market. Therefore, the governments of many developing countries try to attract the attention of investors to the domestic financial market in exchange for improving their international image in the sovereign bond market.

There are several positive expectations regarding the nature and dynamics of the growth of public external debt:

First, the peak of growth of external debt in relation to GDP occurred in 2022 and is expected to decrease in the future.

Secondly, since 2021, the growth rate of the state's external debt has been significantly decreasing. Only since the beginning of 2022, due to debt payments of \$823 million, the state's foreign debt has decreased by 1.7%.

Thirdly, Uzbekistan attracts foreign funds for long periods and from internationally known financial institutions. In particular, the foreign debt portfolio attracted from International Financial Institutions (IMF) is 11.3 billion dollars or 48.7% of the total value of foreign debt. These loans are long-term, unlike relatively expensive loans in the international capital market, they are provided to Uzbekistan at preferential rates for long periods - from 20 to 40 years.

Fourthly, about a quarter of the funds involved are for covering the state budget deficit, three quarters are for energy (25 percent), transport (11 percent) and agriculture (10 percent), housing sector (9 percent) used to finance investment projects. That is, the money raised is not used for consumer purposes, but for energy, transport system and agricultural projects.

Fifth, the resources attracted as external debt are mainly expressed in US dollars (74.8 percent), and also in accordance with the structure of export income, which is mainly formed in US dollars. Thus, there is no additional currency risk when paying the debt.

Sixth, from 2020, Uzbekistan established legal restrictions on attracting foreign debt. Now, not only the maximum size of the annual debt, but also the final level of external state debt (no more than 60% of GDP) is limited by law. According to the Budget Code, the maximum amount of external debt is established by law along with the parameters of the state budget when approving the state budget for the next year. As a result, the volume of foreign debt contracts concluded on behalf of the state and with the state guarantee is constantly decreasing.

Seventh, according to the assessment of the International Monetary Fund, the risk of external debt crisis in Uzbekistan is low, and the ability to service the debt is high. The main sources of foreign exchange earnings of Uzbekistan are stable, that is, export volumes are growing, the volume of cross-border transfers to the country is increasing, the main indicators of the current balance of payments are stable, and there is no threat of default.

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