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Government debt stabilization in a small open economy within currency board system

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Abstract

Sustainability of government debt is a finance priority in most countries of the world. Ideally, government debt should be sustainable at all times. Unfortunately, this is almost never the case in contemporary stochastic economy. Therefore, government debt stabilization tools are employed to contribute to the sustainability of the government debt or maintain the acceptable level of the debt. Selection of government debt stabilization tools depends on many factors, one of which is monetary policy arrangement. Such factors as size and openness of the economy are also crucial for development of government debt management strategy. The objective of the paper is to analyse the peculiarities of government debt stabilization in a small open economy within currency board system.

The main research methods used are systematization and generalization of the scientific literature, quantitative and qualitative analysis of the primary and secondary data, case study, scenario method, graphic presentation of the data and results.

Conclusions of the paper provide the brief review of the main results and findings, revealing the peculiarities of plausible tools and strategy for government debt stabilization in a small open economy within currency board system.

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Keywords: Government debt; debt stabilization; small open economy; currency board.

1. Introduction

The necessity for the stable public finance is undoubted imperative for the most countries of the world. This is especially evident in recent years. Recent worldwide economic recession once more demonstrated the vulnerability of the public finances in most countries of the world. In the paper, only general government debt (further in the text

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– government debt) is considered. During the recession, in many countries, at least short term violation of sustainability of government debt was evident. And in many cases, it was obvious that sustainability of government debt is non-existent. Therefore, prompt changes in government debt strategy were necessary to be made in order to improve the long term indebtedness situation. Due to the aftermath of the recession, government debt stabilization tools were necessary to be applied. Success of application of such tools varied among the different countries and regions.

In order to be able to stabilize the government debt, selection of appropriate government debt stabilization tools and strategy is essential. As in scientific literature there are many possible approaches to the problem, in this paper, first of all, specific standpoint on the issue is described. It is argued that as stabilization of the government debt can be described as being concurrent with the sustainability of the government debt, it is assumed that both of them have common genesis. In its own turn, government debt sustainability and the means to maintain it are quite widely analysed (e.g. Faraglia et al., 2013; Legrenzi & Milas, 2012; Goldstein, 2010; Frank & Ley, 2009; Burcu & Veli, 2008; Yilanci & Özcan, 2008; Afonso, 2005). In the paper, it is also argued that stabilization of the government debt should be ensured at all times, and government debt stabilization tools should be used as prevention means.

While the significance of having stable finance system is important to the most countries of the world, small open economies should be extra concerned about the government debt stability issues due to their dependence on the global economy (Agliardi et al., 2012; Jeanne & Ranciere, 2011; Pisani, 2011; Cuadra & Sapriza, 2008; Damijan, 2001). Governments of such economies should be more conscious of the threat of stochastic nature of the economy and risks caused by it. Therefore, even more reserved strategy (in comparison with the strategy of big open economy) of the government borrowing should be considered.

Furthermore, the potential to apply government debt stabilization tools depends on many different factors, specific to the analysed economy. One of the main critical factors, and the object of this paper, is the monetary policy arrangement. If economy is within currency board system, its options to select different government debt stabilization tools are limited in terms of controlling the impact of the change of monetary policy on the economy (Campa, 2012; De Grauwe & Ji, 2012; Afonso, 2005; Dafflon, 2002).

Considering all the stated, the research problem can be described as the identification of peculiarities of rational government debt stabilization tools set, which, given that the above described prerequisites should be met, could be used in small open economy within currency board system. Accordingly, the aim of the paper is to analyse the peculiarities of government debt stabilization in small open economy within currency board system.

The main research methods, used in the paper are presented in the Method's part of the paper. The main research methods are the systematization and generalization of the scientific literature, quantitative and qualitative analysis of the primary and secondary data, systematic approach, case study, scenario method, graphic presentation of the data and results. Lithuania's case is analysed. Data for the research was collected using scientific literature, reports of the national institutions of the countries analysed, data provided by the official national and regional departments of statistics, official international institutions and organizations, such as International Monetary Fund, World Bank etc. The main results and findings of the research are presented in the Results' part of the paper. The main peculiarities of government debt stabilization tools in small open economy within currency board system are presented in the Conclusions' part of the paper. Also, specific limitations of the research and the future research prospects in this field are discussed.

2. Method

Different methods were used to accomplish different tasks of the research. However, holistic approach was used to ensure the consistency of the research.

In order to achieve the goal of the research and deliver reliable results, specific set of limitations and prerequisites of the research should be set and specify the area of the performed research. The main research limitations include the monetary policy arrangement, openness and size of the economy. Therefore, research focuses on economies, that are open, small and within currency board system. The research results, respectively, are applicable only for small open economies within currency board system. The research does not include analysis of the government borrowing need or its management. Also, the effectiveness of the usage of borrowed assets is not analysed. The research is

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