Local Governments and the financial markets: problems and prospects of interaction in Belarus

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Yuri Krivorotko, Associate professor,
Head of Finance and Credit Department of the Higher School of Management and Business at the Belarus State Economic University, Belarus, Minsk

E-mail: kriv@bseu.by; kriff@rambler.ru

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Abstract
The issues of municipal borrowing in Belarus local financial management are concerned. The first steps in municipal loans development are analyzed. In the paper the history of municipal security has been shown. The author shows positive results and problems received by the results of the first municipal loans in Belarus. The conclusions concerning the ways of further development of municipal borrowing in Belarus are made by the author. The main problems to be resolved are the following: creation of municipal borrowing legislative base in Belarus; integration of municipal loans into structure of local budgets, introducing of a special economic regulation on a municipal debt, tax exemption of municipal security holder, dividing municipal budget on operational budget and investment one, evolution of book-keeping and accounting in local administration, etc.

Introduction

Municipal loans act as an important component of a local financial management mechanism. In global practice they are a normal source of local budgets revenues. It is enough to note, that the share of municipal loans in local budget revenues of the Central and East European countries makes rather significant size. So, in 2001 this parameter in Slovakia made 38,9 %, in Czech Republic - 29,0 %, in Estonia - 18,3 %, in Poland - 15,4 %, in Hungary - 6,3 %, in Russia - 4,0 %, in Romania - 1,98 % (Swianiewicz. P, 2004, p.399).

In CIS countries municipal loans can be performed in three basic forms: interbudgetary loans, credits in banks and bonded loans. It is known, that bank credits are more convenient for covering of short-term cash breaks; interbudgetary loans - for covering of deficiency of the local budget; bonded loans - for financing long-term capital investments. However in transitional conditions an attraction of bank credits inconveniently and it until recently generated various bill circuits. Financing of deficiency due to interbudgetary loans is at a loss deficiency of higher budgets. Allocation of long-term bonded loans is also connected with difficulties due to short-term character of the capital markets and absence of “long money“. Besides it is necessary to note, that bonded loans are favorable only at their great volumes that also is the limiting factor in their use. Since 1992, however, bonded loans began to draw the increasing attention of local authorities in the transition countries including Belarus as well.

Serious reserves of Belarus local government finance to be developed are focused on the ways and methods for accessing to the financial markets. According to Belarus Law on Local Government and Self-Government the local governments can accumulate their financial resources due to loans. In practice, however, the Belarus local governments have no full access to the financial markets for borrowing. On the one hand, Belarus banks are not ready to grant credits to the local government for investment purposes, because banks have not yet had long-term financial resources due to rather high rates of inflation. Moreover, huge credit risks to lend local government needs are passing through by the banks. On the other hand, subnational governments are also not ready to make loans due to absence of municipal borrowing legislation procedure. Currently, many of local councils do not have their own current banking accounts in the banks and they perform their activity through the banking accounts of local executive committees. It generates serious difficulties for accessing to the financial markets. Therefore, local governments fail serious loans for the current and capital purposes.

The first steps of municipal borrowing in Belarus

Footnote:

1. In Belarus the Chairman of local executive committees are appointed by the President and as a matter of fact executive committees belong to the Central power. Therefore local governments have not their own executive bodies.
The beginning of the first municipal loan in Belarus falls to March, 1993. In that period bonds with a view of borrowings for financing construction of habitation were issued and they should be repaid in one year. The loan consisted of 2250 bonds of different face value (return of 30 per cent per bond) on a total sum of one billion Belarusian rubles (equivalent of 1250000 USD). Later the municipal borrowings have found evolution in the next bond issues indicated in table 1.

Meanwhile, opportunities to win the rights for purchasing of apartments in Minsk have been very important.

However, only 41 bonds have been sold at the Minsk stock exchange. Other bonds have been transferred to the National Bank of the Republic of Belarus to be a pledge for the credit of 1 billion roubles. After the end of bond repayment the loan has been paid for the National bank by means of the apartments sales at the auction intended for a lottery.

At the same time, the first experience of the local loans in 1993 cannot be named successful due to confluence of various circumstances: economic crisis, high rates of the inflation, full absence of legislative base and regulation of making loan processes. However, the positive sides of municipal loans have become an experience of targeted loans mechanism, its legal base regulating issues and the circulation of municipal securities, development of organizational structure of the loan making: control and advisory councils on local bonded loans, etc.

Later, development of municipal loans has found the display in the subsequent issues (see table 1).

<table>
<thead>
<tr>
<th>Borrowings</th>
<th>Duration</th>
<th>Number of issues</th>
<th>Amount of issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>The first Minsk targeted housing loan (one tranche)</td>
<td>1.11.96-30.06.99</td>
<td>1</td>
<td>500 (mil. Belarusian rubles)</td>
</tr>
<tr>
<td>The second Minsk targeted housing loan (one tranche)</td>
<td>22.11.96-22.11.02</td>
<td>1</td>
<td>3900 (mil. Belarusian rubles)</td>
</tr>
<tr>
<td>The first Brest targeted housing loan (two tranches)</td>
<td>22.11.96-22.11.02; 6.07.99-10.07.01</td>
<td>2</td>
<td>1500 (mil. Belarusian rubles)</td>
</tr>
<tr>
<td>The first Grodno targeted housing loan (one tranche)</td>
<td>15.10.99-15.09.02</td>
<td>1</td>
<td>400 (mil. Belarusian rubles)</td>
</tr>
<tr>
<td>The first Gomel targeted housing loan (one tranche)</td>
<td>14.06.00 – 14.10.03</td>
<td>1</td>
<td>2000 (mil. Belarusian rubles)</td>
</tr>
</tbody>
</table>

Source: Author’s own calculations based on the State Committee of securities of the Republic of Belarus reports

As the table figures show the municipal borrowing are limited by the housing construction only. It is quite explained by the cautious and weighed position of local authorities in points of guarantees of loans repayment and by the providing its return.

The financial mechanism of municipal bonds in Belarus was reduced to the following stages: the first - financial resources received from the municipal securities issues should go to the funding of housing construction. The second - repayment of bonds should be performed due to the financial resources received from the sales of constructed apartments. So, all necessary infrastructures for allocation and service of municipal loans have been created in Belarus. It is necessary to note that the mechanism of municipal bond allocation to the local loans through the
Institute of the authorized banks has been organized. The general agents of the Minsk municipal loans were the “Joint-Stock Company "Invest-system ", “Belarus Birzhevoj Bank, Joint-stock commercial bank “Belinvestbank”.

Mechanisms of primary bonds allocation for local borrowing have been created by “The Belarus currency stock exchange” and they became more convenient for authorized banks.

Since 2000 stock exchange auctions on allocation of targeted bond housing loans began to be performed. The authorized banks which carry out the function of bonds allocation for local loans have been accepted in security market workshop and they have passed a procedure of the admission to the municipal securities tenders. In coordination with “the Central Republican depository of securities” a function of clearing depository at the municipal securities market is performed by the exchange depository. The sphere of the secondary municipal securities circulation through a stock exchange has carried out only.

By the beginning of 2002 municipal securities occupied place in security portfolios of the Belarus banks. Their share, however, was insignificant and made 1.1 % in trading portfolios of Belarus banks. It is illustrated by the following table.

<table>
<thead>
<tr>
<th>Table 2</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>The structure of security portfolios of Belarus banks by the beginning of 2002</td>
<td>(per cent)</td>
</tr>
<tr>
<td>Content of security portfolios of Belarus banks</td>
<td>Share in per cent</td>
</tr>
<tr>
<td>1. Bills of exchange issued by the Central government organizations of the Republic of Belarus</td>
<td>66.9</td>
</tr>
<tr>
<td>2. Bills of exchange of other residents</td>
<td>8.0</td>
</tr>
<tr>
<td>3. Own banking bills of exchange redeemed</td>
<td>2.5</td>
</tr>
<tr>
<td>4. Bills of exchange issued by the National bank of the Republic of Belarus</td>
<td>2.5</td>
</tr>
<tr>
<td>5. Shares</td>
<td>1.3</td>
</tr>
<tr>
<td>6. Other securities</td>
<td>1.3</td>
</tr>
<tr>
<td>7. Bills of exchange of banks</td>
<td>1.2</td>
</tr>
<tr>
<td>8. Municipal security</td>
<td>1.1</td>
</tr>
<tr>
<td>9. Bills of exchange of foreign banks</td>
<td>0.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Author’s own calculations based on the National bank of the Republic of Belarus securities reports.

In spite of insufficient share of the municipal security in bank’s portfolios (see table 2), the Belarus municipal bonds have got a certain investment appeal. First, they have got the profitableness more closer approached to the refinancing rate of the National bank of Republic of Belarus as the Central bank. Second, municipal securities have passed listing on the “Belarus currency stock exchange”, and depending on financial and economic parameters of the local bodies issued these securities. They are included into quoted sheet of stock exchange. As a result, transparency and publicity of the housing bonds segment into securities market have risen. Third, housing bonds possessed a sufficient degree of liquidity. For example, a municipal securities’ coefficient circulation on a exchange trading system has made 3.4 in 2003 (Ustoichivost finansirovania – garantia privlekatelnosti, 2004, p.9).

The experience of municipal loans in Belarus has shown that the problem of systematization of local loan process has a great importance. Direct copying and putting of foreign experience into local borrowing practice can bring a negative result because each loan has the features determined
by the political, economic, national, cultural aspects of region. Therefore, application of foreign experience demands adaptation to domestic conditions. The loans as a financial tool of local development are only means to resolve the certain problems connected with normal functioning of municipal economy. It is necessary to mention, that under the realization of municipal programs and projects the first issue to appear is the question of local infrastructure development. The issues of profitability are frequently overshadowed. Therefore, today local authorities badly need an insurance mechanism to be able to "amortize" the shocks connected with "failure" of local bonded loans.

First steps in municipal borrowing practice have revealed that the main guarantee for the investor during the performing of bonded loan is its security. Municipal loans are provided with all material, financial and physical assets which are taking place in the municipal property of municipality.

As a subject of a pledge can act any property being the municipal property except objects having historical, cultural or other value. In this case, however, a pledge is not supposed. On the other hand, the ensuring of loan by the objects of a city facilities (system of water pipes, sewerage and other communal objects) is represented practically illiquid and unattractive assets from the positions of loan repayment in case of loan failure. Therefore, it is expedient to carry out real ensuring of investment loans due to the mechanism of guarantees of authorized commercial banks or creations of special insurance funds or reserve ones.

It is necessary to note, that in the contradiction with the local financial administration practice accepted in the world, the concepts of local budget, investment process, loans and municipal securities are separately considered in Belarus. It limits an opportunity to estimate borders of practical utilization of securities by the local authorities. Actually, the issues of the budget and debt securities are deeply interconnected. The using of loans by means of securities opens for the local government bodies a real opportunity to finance local budget expenditures by the purposes - to accept various investment programs and projects to finance them due to borrowing. It allows not only to provide the common equation of the budget, but also to balance structure of budget expenditures that enables local authorities to manage the regional reproduction process. On the other hand, the budget of development predetermines a borrowing policy of municipalities and establishes their needs in dependency on municipal facilities. Weakness of municipal loans in Belarus is their unilateral orientation - housing construction only. Municipal loans having also an important social and economic value, for example, telephone bonds, electricity bonds, rural bonds, etc., are not performed.

During municipal borrowing process an important point is profitability of municipal bonds. There is a contradiction between constantly growing depreciation of Belarus currency and unwillingness of investors to put the capital into projects of city facilities and other public projects with low circulation of investments. Taking into account low recoupment of communal services objects, it is expedient to define profitability of bonds not below than the level of similar governmental securities. Thus it is necessary to provide appeal of bonds due to use of various kinds of income. For example, commodity income, monetary income, investment income, benefits from the property right to object of the loan. One of the attractive sides of municipal securities should become privileges and preferences in taxation of municipal bonds holders. This approach is not new. In the overseas countries tax privileges and preferences are the main party of municipal loans appearance. In Belarus, meanwhile, a full clearness in the municipal bond taxation and transactions on them is absent. In Russia, for example, the securities issued by the subjects of federation are equal to governmental security and transactions operations on them are exempted from tax.

The analysis of Belarus municipal bonded loans has determined their following sequence: accumulation of financial sources or allocation of bonds, using of the accumulated financial
sources for purpose of investment project, interest rate payments (at issue of coupon bonds), return of financial assets to holders or bond repayments. Thus, in this sequence the mechanisms of the accumulated funds may be different only. The methods of the accumulated funds mechanisms which is used in targeted loans are so various, that allow to resolve practically any effective financial problems. The most widespread is the mechanism of the investment project implementation with using of the municipal loan. The essence is that the effective investment process of the accumulated funds should be implemented in municipality interests. Thus, realization of the given project is the basic purpose of loan implementation. Therefore, bonds of the targeted municipal loan may have exchange character and should be converted whenever possible in the shares of project on purposes of which issue has been made. It considerably raised appeal of municipal bonds on a securities market.

Despite little success during the organization of local loans implementation has reached in Belarus, further work will demand coordinated actions of all governmental and non-governmental institutions. The special attention concerning decision-making mechanisms for local loans, selection of structures to participate in loan process and control over the loan procedures and also the systems of taxation and guarantees should be taken into account.

The problems of municipal loans evolution in Belarus

Further development of municipal loans process as an important tool of a local financial management badly needs some radical measures to be introduced in a direction of access of the Belarus local authorities to financial markets.

1. The important direction should become the creation of local borrowing regulation mechanism in Belarus. A central part of that mechanism should be a legislative base of municipal credit. A nucleus of such base should become “The Law on the municipal credit”, providing the procedure of sanctions to loans, access of the local governments to financial markets, authority to borrow, guarantees, debt services, loan repayment, security for debt, loan limitations and other points.

2. Another important component should become the development of municipal loans economic regulation. Usually economic regulation of municipal loans includes two basic elements: approval of the municipal loan by the Central government and system of debt limitations. Any municipal loan should meet with approval of the Central government in any form. Such approval is connected with a coordination of municipal loans and their purposes with a uniform public policy in Belarus and also the loan insurance in a case of “failure” of the loan and providing the possible financial assistance to municipality for debt repayments. On the other hand, loan approval should create an atmosphere of encouragement and confidence at creditors and at the public in correctness of loan implementation. As to loan limitations, that component requires to work out three kinds of limits: a limit on aggregate amount of indebtedness, a limit on amount of debt services and other restrictions (prohibition of municipal loans except for financing of municipal investment projects only; restriction of short-term loan repayment by the terms of fiscal year; loan limitation by the of the unused rests of previous loans; restrictions of the loan depending on performance of the budget, passing of independent external audit in cases of default of principal and interest, etc.).

3. A serious precondition of municipal loans evolution should become improvement of local budgeting process. Further evolution of municipal loans in Belarus urgently demands division of local budgets into the operational budget and capital one. Now the local budgets are not developed without their corresponding division into operational and capital budgets as it takes place in the oversees countries and transition ones. Such rules of local budgets division will allow to increase the transparency of the local finance management. It also facilitates to estimate whether the current revenues are sufficient to cover operational expenditures or revenues on capital investments for
financing investment programs. This information supports construction of viable programs of capital development and helps to estimate creditworthiness of municipality.

4. An important condition for municipal loans evolution in Belarus should be an expansion of budgeting horizons up to 7-10 years. Actually, the procedure of setting up and performance of the long-term municipal budget provides communication between strategic purposes and concrete procedure of investment realization and allows performing the control over implementation of investment decisions. Besides of the long-term budgeting represents an analysis process of a possible investment choice for municipality and decision-making to choose a set of available alternatives. It also promotes revealing of potential risks of the investment projects connected with their realization. The long-term sliding of local budget establishes the sums and terms of capital expenses expected, the revenues received on a separate existing and new projects, defines municipal need for loans and provides the necessary information for maintenance of liquidity of local budgets.

5. There is one more precondition for municipal borrowing improvement in Belarus. It is connected with setting up of the book-keeping report or balance at local government. Presence of municipality book-keeping reports will allow to define credit rating, creditworthiness, solvency, reliability or unreliability of the potential borrower. It also gives economic information for potential investors who are ready to invest on the local level.

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