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The Financial Aspect of the Economic Diplomacy

CONSTANTINE FLISSAK¹¹

Abstract: In modern conditions the special direction of foreign economic interests of a state is to ensure adequate financial resources in the economy. Governments are establishing cooperation on this matter with other countries and with international financial organizations. The subject and problem of national debt and external borrowing are among the most important in modern economic life of each country, regional, supranational entities and international organizations. Active diplomatic support and application of tools of economic diplomacy in the settlement of problems of external debt are necessary.

Keywords: Economic diplomacy • External debt • International finance • International economic organizations

Introduction

One of the defining conditions to ensure effective national foreign economic activity for economic diplomacy must be the focus on the main directions of economic and political priorities, as well as the mandatory coordination of tactical goals of economic diplomacy with strategic units of the foreign economic policy of the state.

Among the components of foreign economic activities on the first place, as evidenced by numerous publications on issues of foreign economic cooperation and international activities, belong to the foreign trade in goods and services (A.Kireev, 2006; P.Krugman, M.Obstfeld, 2004; C.McConnell, S.Brue, 1992; A.Mikhajlushkin, P.Shimko, 2008; F.U.Jahrmann, 2004; U.Broll, 1997). Investment cooperation occupies the second place. For it is particularly relevant to the involvement of the direct foreign investment in the economy of Ukraine. This requires active cooperation with the countries-investors, both with those that have been working in Ukraine, and new and potential investment partners.

A separate direction in the implementation of foreign economic interests is formed by labour migration. On the one hand, a significant number of labour migrants arrive to the country annually – people who choose Ukraine as a place of employment and income. On the other hand, several million Ukrainian citizens are working abroad. Settlement of questions of employment of foreign citizens in Ukraine and Ukrainian abroad goes beyond purely economic issues and extends to social sphere. Derived from them are questions of migration, legal and administrative, fiscal and budgetary, social insurance and others.

The special direction of foreign economic interests can be grouped in the segment of financial and credit cooperation of Ukraine. The contacts with specialized international organizations, both global and regional are a priority here. This direction of foreign economic interests concerns development of cooperation of Ukraine in the sphere of external borrowing and settling foreign debt problems. However, as evidenced by the analysis of domestic and foreign scientific publications on the problems of the world economy, international economic relations and foreign economic activity, the research of this direction of economic diplomacy and the application of its instruments in this area remains virtually out of the sight.

Literature Review

Both domestic (V.Vergun, L.Kistersky, V.Morozov, S.Mocherny, O.Rogach, A.Filipenko, O.Sharov) and foreign (G.Dieckheuer, H.Wagner, M.Eng, F.Lees, L.J.Mauer, A.Kireev, P.Krugman, M.Obstfeld,

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A.Likhachev, L.Fedyakina) authors place high emphasis on these questions (Economic Encyclopedia, 2000; O.Rogach, 2003; O.Sharov, 2008; G.Dieckheuer, 2001; H.Wagner, 2009; M.V.Eng, 1995; A.Kireev, 2006; P.Krugman, M.Obstfeld, 2004; A.Likhachev, 2006; L.Fedyakina, 2005). However, largely open is the question concerning activation of the use of means and methods of economic diplomacy in solving a wide range of emerging issues in the prevention of unprofitable steps on the part of borrowers—subjects of external debt, particularly in government debt and government-guaranteed debt in the context of asserting and protecting national economic interests of the state.

The aim of this article is to examine the specifics of the financial component of economic diplomacy, to mark out and characterize its objects, to show the scope of its application and direction in foreign trade, investment partnership, international cooperation and external borrowing, and to determine the components of diplomatic support in the field of public debt and the necessary tools for this.

Basic Results of the Research

The studied field of activity has a significant potential in ensuring the effectiveness of the financial component of foreign economic relations, to prevent the negative effects of the crisis and in settlement of the existing problems. At the substantiation the mechanisms of application of economic diplomacy tools in financial matters require clear division and structuring by spheres and directions.

The objects of the financial component of economic diplomacy in the system of foreign economic relations are:

- 1) pricing aspect of external trade;
- 2) investment collaboration;
- 3) international financial cooperation;
- 4) external borrowing.

Systematization of areas of application and directions of financial component of economic diplomacy are shown in Figure 1.

The pricing aspect of foreign trade as the financial component of economic diplomacy primarily shows itself in the compliance with the pricing parameters and price optimization, because it forms the basis of the final financial result directly from both the exporter and the exporting country. The first of them receives the financial result in the form of profits and the country of origin of exports receives the export duty and related tax revenues. Furthermore, we consider that the financial component of foreign trade includes the prevention of dumping, because anti-dumping measures from the side of partners can result in the form of relevant trade, economic and financial sanctions (restrictions in export trade with all the ensuing consequences and penalties).

By applying the tools of economic diplomacy significant improvement in the efficiency of foreign trade operations is possible due to the financial component. This is confirmed by examples of work of economic departments in Ukrainian diplomatic missions abroad. For example, the factor analysis of dynamics of Ukrainian export to Germany made by the Trade and Economic Mission of the Embassy of Ukraine in Germany showed that there were 2 different processes: the first was the decrease in the value of total exports of 5.1%, or \$40.7 million, and the second one – they received an increase in physical volumes of imports from Ukraine during the same period by 63.2%. This was due to lower average export prices on Ukrainian exports to Germany by 41.8%. Based on this analysis, the Trade and Economic Mission has made and implemented a complex of measures of informational and organizational nature jointly with Regional State Administrations and with the assistance of the Ministry of Economy of Ukraine. As a result, by the end of the following year in the Ukrainian export to Germany during the decrease in natural volume of supplies by 36.1%, an average increase of export prices of 47.9% was received, which provided an increase accumulation of the financial result in the Ukrainian economy (A.Flissak, 2005).

The financial component of economic diplomacy in foreign trade operations is also involved in the work of diplomatic missions in the host countries in struggling against discriminatory manifestations from the side of foreign partners to the domestic subjects of foreign economic activity in foreign markets (V.Samojlenko, 2011).

In the investment cooperation, the demonstration of the financial component is the attraction of financial resources of foreign investors into the country's economy, investment in profitable projects abroad, as well as the implementation of complex of measures on minimization of risks for investors.

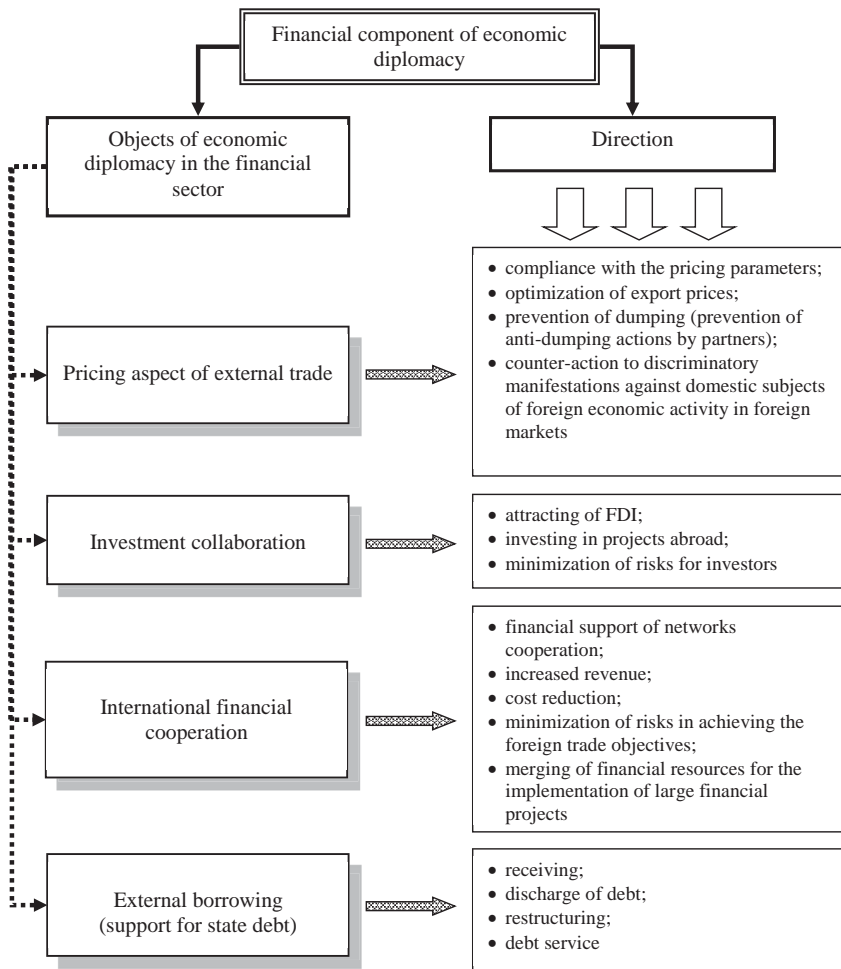


Figure 1 The Scope of Application and Direction of the Financial Component of Economic Diplomacy

While building the system of international cooperation relations and developing international cooperation using the tools of economic diplomacy, the financial component covers financing of cooperative networks, increase of revenues and reduces costs, minimization of risks in achieving the foreign economic activity objectives (Kaufman, 1990; K.Flissak, 2009).

It should be noted that the financial vector of economic diplomacy in considered spheres of foreign economic activities can be implemented in the complex of measures of support of exports and expansion in foreign markets, in establishing the investment partnership and formation of international cooperative relations. A separate and independent place here should be taken by a complex of measures on the use of diplomatic tools concerning foreign borrowings (K.Flissak, 2013).

In the conditions of market economy the emergence of a debt is an objective consequence of the financial, economic and commercial activities. The situation when different business entities in connection with the irregularity and the discontinuity in time of the formation of income and expenditure involved so that some of them always have a permanent surplus over current requirements, another – in contrast – the deficit relative to the needs in cost implementation. Hence, an integral element of the globalized world

economic system in question of settlement of insufficiency of funds for economic development, the realization of socio-economic development, financial support, implementation of new and emerging technologies and innovations is the involvement of third-party funds and external financial resources. At the micro level usually bank loans are used for such needs. At the macro level they turn to borrowing, both internal and external. As a result of such engaged funds debts are formed: trade payables and indebtedness under received bank loans at the level of enterprises and business entities; at the state level debt – public and publicly guaranteed – emerges. Economic history of the modern Ukrainian state demonstrates a significant impact of the factor of formation, servicing and repayment of external debt on the socio-economic development.

The issue of external debt in international economic activity has become particularly relevant in the last decade. The problem of the increasing efficiency of external borrowing and settling of foreign debt became particularly sharp under the impact of the global financial and economic crisis in 2008-2010. For its solution at the level of countries and international organizations a system of mechanisms and instruments of influence was used (Dieckheuer, 2001), among which a special role belongs to the economic diplomacy. It must be emphasized that one of the determining directions of ensuring efficient foreign economic activities of their country is orientation of economic diplomacy on the main vectors of economic and political priorities, and mandatory aligning its objectives with strategic tasks of the foreign economic policy of the state. The means of economic diplomacy provide escorting of external debt of the country from the search and arrangements with creditors of new credit until its repayment. Often, as practice shows, it is necessary to make significant efforts to resolve problems, eliminate bottlenecks and contradictions between the parties (lenders and borrowers) in the process of using external borrowings.

Analytical evaluation of the situation with attraction of external loans, use and servicing of the external debt used as the basis for determining the 'pain points' of application of efforts of representatives of economic diplomacy both in Ukraine and in the countries of residence of diplomatic missions, which are our current and potential creditors. As an important element here one should consider the formation of a system of evaluation criteria both on the part of foreign creditors relative to Ukraine (concerning the reputation of the borrower, risk level of returning the funds, terms and volume of lending) and from the Ukrainian side relative to the desired and expected borrowing (concerning conditions, special comments, rates, benefits, service, repayment, possible restructuring etc.).

It should be noted that external borrowings and external debt are directly associated with the international movement of capital and investment, which is accompanied, on the one hand, by investment in a country's economy, on the other hand – the outflow of capital, and sometimes by its fleeing the country. However, not all external borrowings are transformed into investment, part of them is used to finance social programs and activities, for the temporary closure of financial failures, repayment of previously obtained loans and cover the budget deficit. Dynamics of external debt of Ukraine in the last ten years is shown in Table 1.

Table 1

Dynamics of External Debt of Ukraine (according to the IMF methodology)

Year	Gross external debt at the end of period			
	\$ millions	increase relatively to previous period		in per cent of GDP
		\$ millions	in per cent	
2005	39 619	+8 972	+29.3	45.9
2006	54 512	+14 893	+37.6	50.6
2007	79 955	+25 443	+46.7	56.0
2008	101 659	+21 704	+27.1	56.5
2009	103 396	+1 737	+1.7	88.2
2010	117 346	+13 950	+13.5	83.1
2011	126 236	+8 890	+7.6	74.6
2012	134 625	+8 389	+6.5	73.7
2013	142 079	+7 454	+5.3	74.6
2014	126 308	- 15 771	-11.1	95.1
2015	126 976	-10 094	-7.4	122.8

Note: 1) The data for 2015 are as of end June 2015.

2) Composed by the author on the basis of the main socio-economic indicators; External Debt of Ukraine; the National Bank of Ukraine Bulletin, 2015.

The topic and problems of national debt and external borrowing are among the most important in modern economic life of each country, regional supranational entities and international organizations. It has become particularly sharp since the last financial and economic crisis 2008 and it is still relevant to date. Certain disbalances in the use of financial and credit resources, ignoring the requirements of effective use of credit resource, overreliance on consumer loans and unsecured loans in some European countries (especially in Greece, Portugal, Spain, Iceland, and Italy) and in the United States of America have extremely exacerbated the external debt problem. To a certain extent these problems also affected Ukraine, where they coincided in time with the impact of the global financial crisis and the accumulation of unresolved internal problems in part of accumulation of necessary financial resources for the needs of economic development, employment generation and exclusion of the declining social standards. The problem of external debt in Ukraine has exacerbated due to shortage of its funds for the modernization of manufacturing industries, high level of depreciation of basic production assets, high level of shadow sector in the economy, lack of funds for timely financing of social programmes and activities.

In the modern world external debt has become a widespread phenomenon in the world economy (Fedyakina, 2005; Rogach, 2003). It should be mentioned that in the world economy there are two poles of external debt: on the one hand a small group of creditor countries and international credit institutions; on the other hand a large group of countries debtors. The idea that countries with developing and transition economies are more disposed to borrowing has dominated for a long time. But the trends of the XXI century clearly deny this: among the main debtors are the most developed economies of the world. During 2010-2014, the public debt of EU countries increased from 10004.3 milliard euros to 12094.6 milliard euros, while the ratio of external debt to GDP increased from 78.2% to 86.8%, and in 2014 in 16 of the 28 countries of the EU the public debt exceeded maximum rate of 60% of GDP (data: Staatsverschuldung). According to the International Monetary Fund data, developed countries have the highest levels of ratio external debt to GDP. The data concerning the ratio of external debt to GDP is given in Table 2.

Table 2

The Ranking of Countries according to the Level of External Debt at the end of 2014 (R.Dobs, 2015)

Rank	Country	The ratio of external debt to GDP, in %
1	Japan	400
2	Ireland	390
3	Singapore	382
4	Portugal	358
5	Belgium	327
6	Netherlands	325
7	Greece	317
8	Spain	313
9	Denmark	302
10	Sweden	290
11	France	280
12	Italy	259
13	Great Britain	252
14	Norway	244
15	Finland	238
16	USA	233
17	South Korea	231
18	Hungary	225
19	Austria	225
20	Malaysia	222
21	Canada	221
22	China	217
23	Australia	213
24	Germany	188
25	Thailand	187

Practice shows that the larger the external debt is, the more often problems arise and the conflicts of interest between lenders and borrowers ripen. In addition, under favourable circumstances for creditors and substantial debt obligations of borrowers creditor countries and international organizations-creditors receive opportunities for huge economic and political influence in different parts of the world in their own strategic interests. This reaffirms the need for active diplomatic support and application of tools of economic diplomacy in the settlement of problems of external debt.

As is well known, the indebtedness of the state can be divided to the directly public debt and the publicly guaranteed debt. The latter can appear in cases of receiving investment loans to firms, companies and other business structures under the state guarantees. Such guarantees may occur during implementation of important investment projects of national significance with the assistance of external borrowings. Both components of government borrowings are divided into internal and external debt. External part of public debt and publicly guaranteed debt is an object of support by economic diplomacy at all stages of its movement (receiving, maintenance, restructuring and repayment). Table 3 summarizes data on the structure and dynamics of national external debt of Ukraine, and Table 4 provides data on the structure and dynamics of state-guaranteed external debt.

According to the data in Table 3, more than one third (34.8% at the end of 2014) of public external debt of Ukraine was formed through the international organizations of economic development (International Monetary Fund, the World Bank, the International Bank for Reconstruction and Development, International Finance Corporation, the European Bank of Economic Development and others). While the pace of growth of external loans of the state amounted at the end of the period: in 2006 +12.6%, 2007 +8.0%, 2008 +5.5%, 2009 +52.4%, 2010 +34.2%, 2011 +7.3%, 2012 +6.6% 2013 +6.9% in 2014. +10.8% the significant role in the formation of national external debt was played by securities on foreign markets issued by Ukraine. If at the end of period in 2009 due to them government borrowings in amount of 29.6% of the total sum were received, then in 2012 - 50.1%, in 2013 – 62.2% and in 2014 - 56.1% of the total sum.

Using the funds that form the national debt anticipates its allowable limits exceeding which is a signal about inefficient, illiquid and insolvent economy. In different countries the following "threshold" levels of public debt are established on a legal basis, exceeding them is unacceptable and requires immediate effect on the spending chain and introduction of maximum economy mode. In Ukraine the Budget Code (article 18 paragraph 2) requires that "total amount of state debt and guaranteed state debt at the end of the budget period may not exceed 60% of the annual nominal gross domestic product" (The Budget Code of Ukraine, 2010).

Activities associated with the flow of funds, received from foreign borrowings covers four components of movement relative to the external debt, including: obtaining the necessary amounts, repayment of debt, debt restructuring on external debt, and public debt service. Therefore constituents of the diplomatic support in the area of public debt should cover the full range of necessary tools, in particular:

- information and analytical support of subjects of the Ukrainian side (state, banks and business entities);
- organizational and preparatory activities for negotiations, implementation of the necessary preliminary consultations;
- direct conducting of negotiations;
- evaluation of the borrowers' macroeconomic indicators, including solvency, liquidity, directions of debt usage, its impact on national and economic security of the country.

In cases when a country becomes unable to repay the full amount of the debt or its part in the action the authorized government representatives of the economic diplomacy must join with the objective to reach agreement on debt restructuring, capitalization or conversion. Improper attention to the debts of substantial subjects of the Ukrainian economy at the state level may lead to a sharp rise in foreign currency debt, accordingly provide additional pressure on the Ukrainian National Bank and create a real threat to national and economic security of the country.

Table 3

Structure and Dynamics of National External Debt of Ukraine

as on December, 31	National external debt at end of period including debt to:											
	Total		international organizations of economic development		foreign governments		foreign commercial banks		issued securities on a foreign market		not related to other categories	
	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent
2005	8 704.4	30.3	2 639.3	27.1	0.7	0.0	...	...	...	3 702.4	42.6
2006	9 803.2	25.9	2 538.5	21.7	0.3	0.0	...	...	...	5 135.7	52.4
2007	10 591.7	23.4	2 483.7	18.3	0.0	0.0	...	...	...	6 171.5	58.3
2008	11 171.8	28.5	3 189.1	15.4	0.0	0.0	...	...	...	6 257.9	56.1
2009	17 022.7	49.9	8 486.4	9.2	0.0	0.0	5 040.5	29.6	...	1 925.1	11.3	
2010	22 836.0	45.7	10 432.3	6.2	2 000.1	8.8	7 096.8	31.0	...	1 891.1	8.3	
2011	24 507.0	43.1	10 556.5	5.5	2 000.1	8.2	8 723.3	35.6	...	1 885.3	7.6	
2012	26 124.6	38.3	10 007.8	4.4	0.0	0.0	13 091.0	50.1	...	1 887.3	7.2	
2013	27 931.8	27.7	7 744.7	3.3	0.0	0.0	17 378.8	62.2	...	1 897.5	6.8	
2014	30 822.5	34.8	10 723.2	3.4	0.0	0.0	17 281.8	56.1	...	1 779.1	5.7	

Note: Composed by the author on the basis of National and State Guaranteed Debt of Ukraine for the last 5 years; National and State Guaranteed Debt of Ukraine as on 31.12.2011

Table 4

Structure and Dynamics of State-guaranteed External Debt of Ukraine

as on December, 31	State-guaranteed external debt of Ukraine including debt to:											
	Total		international organizations of economic development		foreign governments		foreign commercial banks		issued securities on a foreign market		not related to other categories	
	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent	\$ million	in per cent
2005	2 970.5	61.5	1 409.4	23.5	1.0	580.0	25.3	...	...	957.5	41.8
2006	2 858.2	35.4	1 011.0	18.0	0.6	904.9	31.7	...	...	924.2	32.3
2007	3 257.3	20.4	665.1	11.1	0.3	1 790.3	55.0	...	...	790.8	24.3
2008	7 366.2	68.2	5 020.3	1.9	0.0	1 686.4	22.9	...	...	657.5	8.9
2009	9 623.7	66.9	6 441.1	0.0	0.0	1 459.9	15.2	1 595.0	16.6	127.7	1.3	
2010	11 923.6	64.9	7 740.6	190.6	1.6	1 703.9	14.3	2 163.0	18.1	125.4	1.1	
2011	12 967.5	59.4	7 701.5	190.6	1.5	2 097.3	16.2	2 853.0	22.0	125.0	0.9	
2012	12 521.1	40.5	5 074.2	247.8	2.0	3 670.9	29.3	3 403.0	27.2	125.2	1.0	
2013	9 688.3	21.0	2 030.0	247.8	2.6	3 881.6	40.0	3 403.0	35.1	125.8	1.3	
2014	7 986.7	31.8	2 543.7	243.7	3.0	3 273.3	41.0	1 808.0	22.6	118.0	1.6	

Note: Composed by the author on the basis of National and state guaranteed debt of Ukraine for the last 5 years; National and state guaranteed debt of Ukraine as on 31.12.2011

Conclusions

Based on the foregoing, the authorised state institutions in the sphere of external financial relations and representatives of economic diplomacy need to take into account the following main requirements for the formation and management of the external debt of Ukraine:

- 1) settlement of external debt should be systematic, integrated and constant, within the general financial strategy of the state;
- 2) external borrowings must be guided solely by the aim of structural reform of the Ukrainian economy and attracting investment resources should be a priority;
- 3) diversification of external borrowings and creditors should be ensured to minimize the negative impact of creditors on the state in other socio-economic issues.

On this basis it will be possible to get the proper efficiency of the financial component of economic diplomacy in the system of ensuring national economic interests of Ukraine.

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