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THE IMPORTANCE OF SOVEREIGN BORROWING BY DEVELOPING COUNTRIES FOR INVESTMENT PROJECTS AS AN EXAMPLE OF UZBEKISTAN

Abstract. Today, scientific-theory predicts that sovereign governments should borrow to smooth national consumption or to undertake investment projects that they could not finance otherwise. International bond market is the largest investment market in the world, and it has become not only a place to attract cheap and convenient loans, but also a promising place for strategic investors.

This article focuses the ability of developing country governments to borrow from international credit markets over the different stages of the international credit market cycle. The article also analyzes the practice of Uzbekistan, as a developing country, sovereign borrowing. In addition, the impact of these government Eurobonds on the country's economy has been studied on the basis of statistical analysis.

Keywords: International bond, Eurobond, Global bond, Parallel bond, Foreign bond, sovereign borrowing, coupon rate, maturity, government sovereign Eurobonds, international capital market, benchmark.

Introduction

The ability of a sovereign government to borrow on international credit markets depends on its perceived ability to repay and on the incentives it will have to do it. International bonds are considered one of the instruments of the international credit market. In turn, the international credit market is part of the international financial market. The main difference between the international credit market and the national or state one is that transactions with securities occur with resident investors and non-resident issuers who conduct their activities on the basis of international law. The similarity of the international stock market with the state one is that there is also a transfer of capital between several countries. Consequently, securities circulating in the territory of only one country, going beyond its borders, are now referred to as euro securities. It should be taken into account that the prefix "euro" does not mean that this financial instrument belongs only to European countries, although it used to be so before. Now this is a sign that this security may have property rights of absolutely different entities from different parts of the world.

Further, this term has already become an official definition, which was first mentioned in the Directive of the Commission of the European Communities after the first issues of Eurobonds on March 17, 1989 No. 89/298 / EEC. This Directive outlined the fundamental rules for the issue and circulation of Eurobonds among

investor and issuer countries. By interpreting the definition of Eurobonds in accordance with this Directive, it can be seen that financial instruments can be sold to all investors, regardless of their country of origin other than the country of registration of the issuer. Another important point is that Eurobonds can only be purchased through professional participants, such as international credit organizations or a syndicate of international institutions.

The following types of international bonds are circulating on the international bond market, shown in Figure 1.

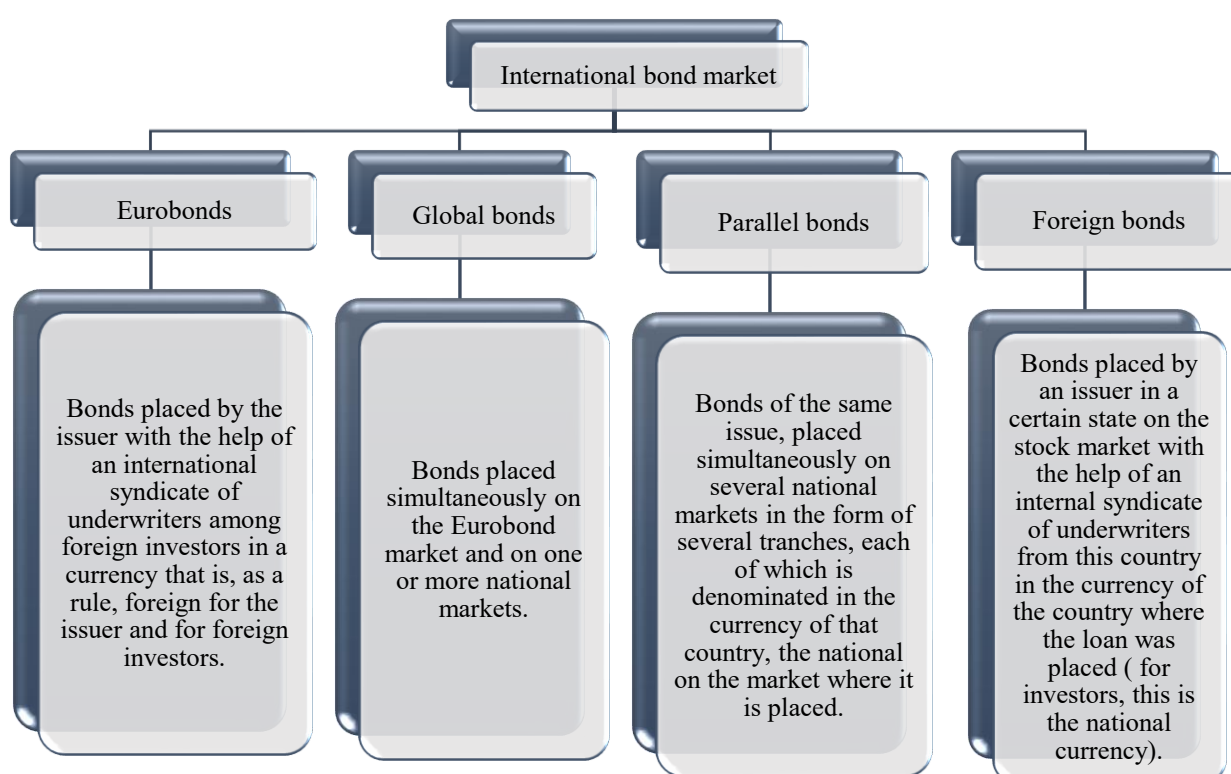


Figure 1. International bonds¹

There are still a number of differences between foreign and national bonds, the most pronounced of which include:

- Various regulatory acts and laws;
- Different systems and norms of taxation;
- Different release mechanism;
- Different maturities of bonds circulation;
- Various volumes and norms of bond issues;
- Various transparency requirements for prospectus information;
- Various rules for listing and registration procedures;

¹ The figure was prepared by the author with the help of economic literature.

— Differences in categories of potential investors.

International bonds, in particular Eurobonds as one of the levers of financing, are, as a rule, a stock market instrument in the long term, providing less risk for its holder. If it is compared this instrument, with such a security as shares, then it can be safely said that, due to the high guarantees of servicing coupon payments, the circulation of bonds requires a transparent and rating assessment of the financial condition of the issuer. And therefore, large successful companies of stable sectors of the economy are considered participants in the Eurobond market.

Literature review

Sh.A. Toshmatov in his scientific article devoted to the first issue of Eurobonds from the side of our republic notes that “The Eurobond market provides high capital mobility on an international scale, as it attracts more loans players and investors than other internationalized financial markets” [1].

F. Andrea in his scientific article with co-authors in IMF Working Paper noted that about participating in international debt markets “Access to international debt markets can be modeled as a two-step process. The first relates to the willingness of sovereigns to access global markets and of the latter to supply funds. The second concerns the price at which demand and supply are settled. If unobserved factors that determine bond issuance also affect spreads, a standard linear model for the determinants of sovereign spreads at issue would be biased because of sample selection, given that the dependent variable (the spread in the primary market) is observed only for a non-random subset of country-year observations. According to this procedure, in the first stage (selection equation), the probability of sovereign bond issuance is estimated by a standard *probit regression*, and in the second stage (outcome equation) the primary spread is a linear function of the set of variables and of the inverse Mills ratio calculated from the first-stage regression, which corrects for sample selection bias” [2].

J. Eaton and M. Gersovitz in their scientific article noted that “Access to international capital markets is likely to be the result of demand and supply factors: disentangling these two would require an exogenous shock in the demand or in the supply schedule. Focusing exclusively on emerging markets and developing economies (many of which are low-income developing countries) should help minimize the cases of voluntarily absence from the market (lack of demand), given that these countries generally need large amounts of external funds to finance domestic investment. Countries, however, could still self-select out of international credit markets, especially in the case of sovereigns with sufficient access to grants and concessional loans. In addition, countries could base their demand for international bonds on expected borrowing costs. While it is difficult to fully control for these costs, especially for first-time issuers for whom there are no secondary

market bond spreads, the information on expected borrowing costs is indirectly taken into account by inclusion of a comprehensive set of domestic and global controls in the selection equation. However, in the absence of an identification strategy, the empirical exercise focuses on factors associated with sovereign bond issuance without implying causality” [3, 4]

Research methodology

In this article, the study of existing scientific research on sovereign borrowing, the study of statistical data and economic comparison and analysis, logical thinking, scientific abstraction, information grouping, analysis and synthesis, induction and deduction methods are widely used as research methodology.

Analysis and results

For any borrowing country, entering the international financial market is associated with a number of goals that they pursue. These goals must be justified, since the country will face a number of innovations during the issue, which can seriously affect the image of the country. For example, for many countries it becomes impossible to obtain a good credit rating, which automatically affects the liquidity of Euro papers. Or, for many countries, the factor of openness of the economy calls into question the issuance of Eurobonds.

Table 1

Risks associated with the issuance of Eurobonds²

Risks associated with Eurobonds	
<i>Credit risk</i>	This type of risk is, of course, associated with the issuer's obligations to pay the full amount of coupon payments within the period specified in the prospectus. For a complete picture, the issuer's credit rating when issuing Eurobonds can serve as an indicator for potential investors.
<i>Interest rate risk</i>	This type of risk can be attributed simultaneously to the micro and macroeconomic indicators of the issuer, both private and represented by the state. This risk is directly related to the average market price of Eurobonds, more precisely, to the fall in their rate.
<i>Currency risk</i>	The most common type of risk that is directly related to international monetary policy operations. Since Eurobonds can be sold in one currency, and coupons on them are paid in another, this can lead to additional income for the investor. (Such risk affects the activity of the issuer).
<i>Liquidity risk</i>	This risk belongs to the risk of a private investor. Investors are exposed to this risk when transactions in Eurobonds are made off the exchange. In this case, the investor has to work with several intermediaries at the same time, which increases the cost of buying Eurobonds. Such a risk may also arise artificially, when external market factors may affect the growth or fall in the Eurobond rate.

² The table was prepared by the author using economic literature

Analyzing the activities of the Republican Stock Exchange "Tashkent", we can see how the volume of trading increased sharply, but given the subsequent depreciation of the Uzbek currency and GDP growth rates, such indicators are not so significant. Many specialists in the financial sector have developed special forms of mechanisms for issuing Eurobonds, which have become a guideline, or a kind of "model" for new participants in the international stock market.

In addition to the above methods of placing Eurobonds, in modern practice there are also more synthesized schemes for placing Eurobonds [5].

Table 2

Comparative analysis of the issue of Eurobonds by the CIS countries [6]

Country - issuer	The volume of state Eurobonds, (billion dollars)	First posting time	Current range of rates of return, (%)	Credit rating of the country on the date of placement of Eurobonds	Placement of the first issue among investors	Excess of the book of applications over the issue, times.
Russia	54,052	October 1996	3,11–4, 95	Standart&Poor's – "BB–" Moody's – "Ba2" Fitch – "BB +"	USA–41%, South Korea–39%, Europe–20%	2,1
Kazakhstan	6,5	December 1996	3,85–5,175	Standart&Poor's – "BB" Moody's – "Ba3"	UK–63%, USA–21%, Europe–16%	4,4
Georgia	0,5	April 2008	6,88	Standart&Poor's – "B+" Fitch – "B+"	UK–56%, USA–13%, Europe–31%	3,4
Belarus	8,78	July 2010	4,5–8,0	Moody's – "B1"	USA–67%, UK–24%, Europe–9%	1,8
Armenia	1,2	September 2013	6,0–7,15	Moody's – "Ba2"	USA–42%, Great Britain–23%, Europe–17%, Russia and Asia–18%	4,3
Azerbaijan	3,5	March 2014	3,5–4,74	Standart&Poor's – "BBB/A-3"	USA–47%, Great Britain–25%, Germany–18%, Singapore and Israel–10%	4
Tajikistan	0,5	September 2017	7,125	Standart&Poor's – "B3"	USA–38%, UK–24%, Europe–35%, Asia–3%	9
Uzbekistan	1,0	February 2019	4,75–5,375	Standart&Poor's – "BB–" Moody's – "B1" Fitch – "BB +"	UK – 39%, USA – 23%, Europe – 32%, Asia – 6%	8,5

There are enough such prerequisites, but it still becomes profitable for many issuers to issue Eurobonds to attract foreign capital. For example, Turkey issued Eurobonds in 2019 to stabilize the balance of payments, while Tajikistan resorted to issuing Eurobonds to modernize the Rogun Hydropower Project in order to become independent from other neighbors in importing electricity. So what were the prerequisites that pushed our country to the first issue?

1. The issue of Eurobonds will help the country to declare itself in the arena of the stock market, which will increase investment attractiveness, and as a result, the volume of foreign capital inflow will increase.

The Republic of Uzbekistan, becoming a participant in the global capital market in 2019, very successfully placed its first Eurobonds, achieving a reduction in coupon payments due to high demand. Although the 2020 pandemic has made its own adjustments and brought to zero the sale of Eurobonds in the secondary market.

2. President Mirziyoyev Sh.M. The Action Strategy for the Development of the Economy from 2017 to 2021 was adopted, which provides for a long-term strategy for our republic to integrate into the global financial market. Thus, the first issue of Eurobonds by the government was an example for subsequent issues of Eurobonds by private investors. Such a move not only determined the price range for issuing international bonds, but also opened a window for future issuers into the stock market.

3. Another important prerequisite is that young states can increase their international prestige by issuing Eurobonds. Since the emission rules require obtaining a credit rating, which reveals complete information about the economy of a particular country. Also, the issue of Eurobonds is cheaper and the rules for issuing are more flexible and convenient compared to other types of borrowing. For example, servicing a syndicated loan is more expensive than Eurobond coupon payments, and besides, international loans have a short maturity, unlike Eurobonds that circulate from 10 years to an indefinite period.

4. In addition, for the further issuance of Eurobonds by any country, it is necessary to clearly and accurately determine the goals and objects of financing. It is not worth taking loans if specific investment projects are not defined, which will be financed by borrowed funds and from the implementation of which income will be received.

“By the Decree of the President of December 26, 2018 “On the forecast of the main macroeconomic indicators and parameters of the State budget of the Republic of Uzbekistan for 2019” The Ministry of Finance of the Republic of Uzbekistan was instructed “during 2019 to issue and place sovereign bonds of the Republic of Uzbekistan at a fixed coupon rate for an amount not less than 500 million US dollars with a maturity of 5 or more years.

On February 14, 2019, Uzbekistan placed the debut two tranches of Eurobonds with a total volume of \$1 billion, as published by the London Stock Exchange. The bonds were placed in a double tranche of \$500 million with maturities in 2024 and 2029.

According to the resolution, in order to effectively use the funds received from the placement of Eurobonds of the Republic of Uzbekistan, including for financing investment projects that have strategies important for the further improvement of the welfare of the country and the population, proposals were submitted by the Ministry of Finance of the Republic of Uzbekistan and the Central Bank.

Table 3

Conditions for the placement of funds from the placement of international bonds of the Republic of Uzbekistan on deposits of commercial banks through auctions [7]

Deposit terms	Maximum deposit amount (in US\$)	Minimum annual rate %	Payment term %	Deposit return period
5 years old	459,6	5,25%	Every 6 months (February 10-August 10)	10.02.2024
10 year old	429,6	5,875%	Every 6 months (February 10-August 10)	10.02.2029
Total	889,2	-	-	-

The table above shows that the received 459.6 million US dollars on 5-year sovereign Eurobonds were placed in commercial banks with a term of 5 years, that is, until February 10 2024. In this case, a 5-year term deposit in foreign currency is placed at a minimum annual rate of 5.25% and is interest income. It should also be noted that the rate of 5.25% is set based on the margin of 4.75% plus 0.5%, at which sovereign Eurobonds are placed. In addition, interest on these deposits is paid by commercial banks every six months, that is, until February 10, 2024, February 10 and August 10 of each year. In turn, funds from 10-year sovereign eurobonds of the Republic of Uzbekistan in the amount of 429.6 million US dollars were placed on the basis of an auction between joint-stock companies merchant banks until February 10, 2029, i.e. for this period of time, a 10-year deposit in foreign currency is provided with a minimum annual rate of 5.875% and interest income is accrued. It should also be noted that the rate of 5.875% is set on the basis of a margin of 5.325% plus 0.5%, placed on 10-year sovereign Eurobonds. Nine months after the Ministry of Finance of the Republic of Uzbekistan, the country's national banks also begin issuing Eurobonds for foreign investors. The first in this arena was the domestic bank Uzpromstroybank. Being one of the largest banks of the republic and at the same time a strategic one, Uzpromstroybank placed its first corporate Eurobonds for a period of 5 years on the London Stock Exchange. Their coupon yield was determined after the auction as 5.75% per annum for a total of \$300 million. Many specialists were interested in buying Uzpromstroybank's corporate Eurobonds due to their strategic goals, which explains the increase in investor applications by \$1.2 billion.

Thus, Uzpromstroybank has become a benchmark for other Uzbek corporate structures interested in attracting foreign capital through the international stock market, on the one hand, and on the other hand, opened access for foreign investors to the domestic securities market.

The funds received from the issue of Eurobonds will be used to increase the economic and competitive power of this commercial bank. But, a concrete and transparent project plan has not been demonstrated to outsiders. Following Uzpromstroybank, Asaka Bank, Ipoteka-bank and the National Bank of the Republic of Uzbekistan issued their corporate Eurobonds.

"Ipoteka-bank" issued international bonds in the amount of 300 million US dollars for a period of 5 years. The debut issue of international bonds was carried out on the basis of the recommendations of such internationally recognized underwriters as J.P. Morgan, Raiffeisen Bank International AG, MUFG, and Society General. As part of the road show of the event with the participation of more than 70 international investors operating in the United States, Europe and Asia, as well as in Russia, a global audio conference (Global Investor Call) was held.

Based on the proposals of investors and the recommendations of financial consultants, the initial interest rate of international bonds of Ipoteka-bank was determined at 5.625%.

In an hour, the volume of orders amounted to more than 300 million US dollars and the volume of the planned issue was completely covered. In the process of trading, the volume of orders

exceeded 500 million US dollars, which allowed to reduce the initial interest rate for the issuer and the final interest rate and coupon were reduced by 0.125% and set at 5.5%. The funds received from the placement of international bonds are planned to be used to finance investment projects and support the activities of entrepreneurs who will contribute to the economic development of our country. Another bank of the Republic of Uzbekistan that has successfully become a participant in the international financial market is the National Bank for Foreign Economic Affairs of Uzbekistan.

The international rating agency Fitch Ratings has assigned this bank a BB- credit rating, meaning "expected long-term rating". Their debut issue was set at \$300 million. The circulation period of the National Bank's Eurobonds was 5 years. Due to the high demand of investors and the fact that it exceeds the volume of the issue twice, the final coupon value amounting to 4.85% per year decreased by 0.30% of the initial interest rate during trading. Such a successful placement of Eurobonds by the bank indicates a positive assessment by international investors of the reforms being carried out in the country. Due to the high demand of investors and the fact that it exceeds the volume of the issue twice, the final coupon value amounting to 4.85% per year decreased by 0.30% of the initial interest rate during trading. According to the analytical data of the National Bank, the proceeds from the issue of corporate Eurobonds are planned to be used to finance the bank's foreign loan portfolio.

Table 4

Analysis of the issue of Eurobonds by national issuers³

Issuer	Issue volume (mln \$)	Coupon rate (%)	International rating (M/F/SP)	Term of circulation (years)	Purpose of issue	Application volume
Ministry of Finance	500 500	4.7 5.3	B1/BB-/BB-	5 10	Deposits of commercial banks; Credit line for Agrobank; Development of the Navoi Mining and Metallurgical Company	3.8 billion
Uzbek Industrial and Construction Bank	300	5,75	-/BB-/-	5	-	1.2 billion
Joint-Stock Commercial Mortgage Bank "Ipoteka-Bank"	300	5,50	-/BB-/-	5	Financing of large investment projects; Creation of a credit history in international capital markets; Diversification of funding sources	500 million
National Bank	300	4,85	-/BB-/-	5	Creation of a loan portfolio in foreign currency	700 million
UzAuto Motors	300	4,85	-/B+/-	5	Empowerment among foreign investors	1.4 billion
Ministry of Finance	555 195	3.7 14,5	B1/BB-/BB-	10 3	Funds from the placement will be used to cover the budget deficit, as well as to finance a number of projects that will be implemented in 2021 for the sustainable development of Uzbekistan	1.6 billion 180 million

³ The table was compiled by the author using economic literature

As can be seen from the analytical data, the issued Eurobonds are very popular among foreign investors, thanks to which the coupon rate can be reduced by several points. Each of the issues is accompanied by a high volume of applications, which indicates that investors are interested in buying securities in a country that until recently had a closed economy. All coupon rates have approximately the same value, which indicates that national issuers are still cautious about setting coupon rates.

Conclusions and proposals

The development of the financial market led to a noticeable increase in its share in the national economy. Now the participants of the financial market, government regulators and the scientific community are faced with the question of further ways to develop this sector of the economy and increase its efficiency.

Upon reaching the goals of becoming a professional participant in the international stock market, the issuing country will be able to use the variety of instruments of the international stock market, increase the investment attractiveness of the country by publishing its micro and macroeconomic indicators. In addition, the issuing country can strengthen the level of confidence on the part of domestic and foreign investors. Such a result will lead to full transparency of the economy for external users, which will positively affect the timely replenishment of the state budget through state taxes. In addition, the status of a professional participant in the global stock market will affect the formation of inexpensive education capital for some organizations in need of funding. Attraction of external financing will solve the problems of refinancing and debt restructuring.

As shown by the analysis of debt issues of Eurobonds by national issuers, the following can be attributed to the advantages of participating in the global borrowing market:

1. The national stock market of the Republic of Uzbekistan today is not sufficiently capital-intensive, and, accordingly, does not solve the problem of cheap financing. Well, entering the world loan capital market, we improve our macroeconomic indicators and, as a result, become investment attractive for large potential investors.

2. The issuance of Eurobonds helps to avoid the marginal costs of transactions associated with obligations, and as a result, financing the state budget is the cheapest in relation to other forms of issuing financial market instruments.

3. The high demand for debut tranches of Eurobonds from foreign investors is explained by the fact that our country has been pursuing a policy of protectionism for a long time, and entering the world stock market has become the beginning of cooperation with many countries. Also positive for the investment policy is the fact that our country has received a credit rating from major international rating agencies, which have previously studied and analyzed the financial condition of the issuer, and then on an ongoing basis will monitor the activities in relation to their requirements.

4. The first practice of issuing Eurobonds by the government of our country was announced as a "benchmark", that is, a kind of benchmark for other financial entities. The main emphasis was placed on the issue of corporate Eurobonds of commercial banks, in which case the banks used the practice of a debut issue, guided by the yield on sovereign Eurobonds as the basis for determining the yield of their own financial instruments. In addition, the resulting sovereign rating is considered the benchmark for the corporate rating scale. This fact can be explained by the

fact that private corporate entities are under the influence of both microeconomic and macroeconomic factors.

5. Issuance of Eurobonds may also have a positive effect on the outflow of national investments, if investors are interested in buying sovereign loans. This conclusion justifies itself, since it is the states that are major borrowers in any financial market, and, accordingly, receive the largest volume of external financing funds.

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