DIALECTICS OF SCIENTIFIC APPROACHES TO DEFINING THE ESSENCE OF DOMESTIC GOVERNMENT DEBT

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Abstract: The article presents the dialectics of scientific approaches to defining the essence of domestic government debt. The results of scientific studies of mercantilists, physiocrats, monetarists, representatives of the Keynesian and neo-Keynesian trends with respect to the essence of domestic government debt and its impact on the efficiency of macroeconomic regulation have been analyzed. The absence of a unified opinion concerning the nature of domestic government debt impact on the economy of the state has been proven, the multi-vector nature of such impact have been determined. The article proves that in modern conditions of the Ukrainian economy the domestic government debt should be considered as a mechanism governing monetary circulation, impact on the development of the capital market, impact on the budget process. In this connection, the category of “domestic government debt” has been specified.

Keywords: domestic debt policy, domestic government debt, debt burden, state budget, government budget deficit, government budget deficit financing, mechanism of domestic government borrowings, macroeconomic regulation.

Articulation of the problem

Implementation of efficient economic reforms in the Ukrainian economy needs considerable investment which can be mobilized at the present stage at the expense of domestic government borrowings that leads to the formation of domestic government debt. In the modern context, domestic government debt is an organic component of financial systems of most countries of the world. In Ukraine, over the years of its independence, the formation of domestic government debt has been influenced by a number of factors, the main of which included significant budget deficits, dependence on energy import, the need to increase foreign exchange reserves to ensure stability of the national currency, the need for technical re-equipment of national sectors of economy.

![Graph showing domestic government debt and state-guaranteed domestic debt of Ukraine during 2010-2015.](www.minfin.gov.ua)

Fig. 1. Domestic government debt and state-guaranteed domestic debt of Ukraine during 2010-2015.

Source: compiled by the author based on the official data of the Ministry of Finance of Ukraine (www.minfin.gov.ua).
Stability of the financial system of the state, possibility of economic and social growth is determined by the state budget, size and dynamics of its deficit, amount of the domestic government debt. It should be noted that during 2010-2015, the amount of domestic government borrowings of Ukraine show a strong tendency to rapid growth (Fig. 1). At the same time, the cost of repayment and service of domestic government debt of Ukraine is raising (Fig. 2).

Thus, accumulation of domestic government debt (Fig. 1), corresponding increase in the debt burden on the state budget (Fig. 2), periodic occurrence of debt crisis, deterioration of conditions on the world financial markets make regulation of internal government debt a priority task for financial policy of the state. In this regard, the need for the efficient domestic government debt regulation system becomes actual in order to transform domestic government borrowings into the efficient tool for socio-economic development of Ukraine, which, in its turn, requires studying the dialectics of scientific views of the essence of domestic government debt.

![Fig. 2. Budget expenditures for repayment and servicing of domestic government debt of Ukraine during 2007-2014. Source: compiled by the author based on the official data of the Institute for Budgetary and Socio-Economic Research of Ukraine (www.ibser.org.ua).](image)

**Analysis of recent research and publications**


**Purpose of the article** is to clarify definition of the category of “domestic government debt” based on the results of study of the dialectics of scientific approaches to the essence of domestic government debt and its impact on the efficiency of macroeconomic regulation.

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Main results of the study

At the beginning of the XVI century mercantilists M. Blaug and T. Mun (2008), M. Blaug and J. Low (2008) were the first among academic economists who expressed scientific view of the nature of domestic government debt, according to which the need for active state intervention in the economy through government expenditure financing at the expense of domestic government borrowings is recognized.

Contrary to the mercantilists, researches of physiocrats F. Quesnay (1960), A. Turgot (1961) concerned, to a greater extent, the area of production rather than the area of circulation; therefore, according to their scientific position regarding domestic government debt when making borrowings the state attracts resources from production sectors of economy thus preventing to create new added value.

In the opinion of classical school representatives D. Ricardo (1817), A. Smith (1962), domestic government debt as part of the budgetary mechanism shall perform the role of solely financial rather than regulatory instrument. According to scientific position of D. Ricardo, the increase in domestic government debt distorts information about the actual financial condition of the state, which makes it impossible to optimize government expenditure. A. Smith argued that government expenditure financing at the expense of borrowings reduces wealth of the nation, deepens the tax burden and prevents capital accumulation. D. Ricardo and A. Smith negatively assessed the practice of loan financing of government expenditure and believed that the state cannot and should not force capital accumulation through expenditures, since government expenditure is not productive by its nature.

Historical school representatives A. Muller-Armack, F. Liszt, G. Schmoller (2012) were the first who raised the question of macro-economic impact of domestic government borrowings. In the works of the authors the domestic government debt was considered as a component of state regulation of the economy. Thus, the theoretical prerequisites have been created for the inclusion of domestic government debt in the system of macroeconomic regulation.

Keynesian theory treats domestic government debt as a tool to influence the economy. J. Keynes (2012) argued that loan financing affects the preservation of and the increase in aggregate demand, which contributes to economic growth. Domestic government borrowings are considered as an alternative of tax revenues allowing, if necessary, to reduce taxes thus stimulating economic growth. It should be noted that it is in accordance with this theory, since 40s of the XX century in many countries the budget deficit has become a chronic phenomenon, and domestic government loans has been becoming more and more widespread.

Monetarism representatives M. Friedman, I. Fisher, A. Meltzer and K. Brunner (1977, 1984) opposed the use of domestic government debt as a tool of macroeconomic and financial stability, not recognizing the existence of positive short-term and long-term effects from the use of this tool.

Stockholm school monetarists G. Myrdal (1956), E. Lindahl (1950) proposed the theory of “cyclic budget balancing”, i.e. government revenue and expense optimization system, depending on the stage of economic cycle. It was assumed that the budget deficit as the result of crisis and depression should be covered by appropriate budget surplus during the period of economic recovery, which respectively mitigated the need for domestic government borrowings as a source of budget deficit financing. In our opinion, this theory may be put in doubt, since it does not take into account the time factor of economy cyclicity, i.e. emergence of chronic budget deficit over a long period, which causes the objective need for domestic government borrowings.

However, there is the position according to which active government regulation of the economy through the mechanism of domestic government borrowings is undoubtedly necessary. At the same time, the main danger of domestic government debt growth lies in the imposing of the debt burden on future generations. This position is reflected in the works of German and American scientists. L. Stein (1886), K. Nebenius (1967), K. Asher (1838) believed that the lack of active use of domestic debt instruments leads to the increase in tax rates, which is contrary to economic activity of business entities and public interests.

K. Marx (1988, p. 764] argued that domestic government loans are the “engine” for initial capital accumulation: “... government debt created joint-stock companies, trade in all possible securities, stock exchange game and modern bancocracy...”.

Note that most economists see the main danger of implementation by the state of active domestic debt policy in the imposing of the debt burden on future generations.

Representative of neo-Keynesian trend in the economy E. Domar (1944) presented the theory of dependence of domestic government debt and economic growth, according to which the higher the
economic growth rate and the lower the actual interest rates, the safer the use by the state of borrowings to finance budgetary expenditure; if the economy is stagnant, there is a risk of non-fulfillment of government debt service and repayment obligations. The author proposes the model of dependence of domestic government debt amounts and GDP which proves that the growing domestic government debt does not necessarily worsen the future fiscal situation due to the increase in tax rates and the growth of government expenditure related to debt service. The determining amount at fixed interest rates (government bond yields) and outstanding share in GDP is the economic growth rate. With positive growth rates of GDP the domestic government debt is serviced without risk.

American scientists K. McConnell and S. Brue (2003) believe that the state is almost always able to fulfill its domestic debt obligations, since it is possible to take advantage of debt refinancing, money issuance or tax revenue increase. According to definition of K. McConnell and S. Brue (2003, p.365), the domestic government debt is the total amount of all positive balances of federal government budgets less all deficits that took place in the country. We believe that this approach is somewhat incorrect because it does not take into account the time factor of attracting borrowings to finance budget deficit, the maturity of domestic government debt, accumulated debt obligations of previous years.

A. Dolan, K. Campbell and R. Campbell (1996, p. 402) believe that the domestic government debt is the accumulated amount of budget deficits of previous years. We do not agree with such an interpretation, because domestic government debt is just one of sources of budget deficit financing.

A deep analysis of the impact of domestic government debt on the efficiency of macroeconomic regulation was conducted in studies of D. Buchanan (1958), in particular, the scientist considers this category as the federal government obligations in the federal political system, according to which the government receives resources available at the time when the debt is created, in exchange for the obligation to make future payments to creditors. Future payments to creditors at the same time include interest payments and repayment of principal amount.

The essence of domestic government debt is studied in the works of modern Ukrainian academic economists. So, O. Vasylyk and K. Pavliuk (2004) believe that domestic government debt is determined by the total amount of issued, however not redeemed domestic government loans with the accrued interest to be paid on a specified date or during a certain period.

In the works of S. Yuriy (2008) domestic government debt is seen as the result of monetary relations, which arise in the process of moving temporarily free financial resources of business entities to the state budget, while the state acts as the borrower, and the total amount of borrowed capital equals the amount of domestic government debt. V. Venger (2009) argues that domestic government debt is formed as a result of state borrowings from among residents.

I. Liutyi (2008a, 2008b) defines the essence of domestic government debt through purposes of its formation and use, which are defined at two levels: monetary (impact on monetary and macroeconomic liquidity) and actual (impact at the level of consumption and saving). In this case the interest rate serves as a link between monetary and actual areas of impact on the economy. Thus, domestic government debt is defined as a mechanism of redistribution of wealth among generations of taxpayers, which causes the increase in debt burden for future generations.

P. Yukhymenko and L. Lazebnyk (2010) define the essence of domestic government debt through distribution, regulatory and control functions of government loan. The distribution function of government loan involves redistribution of financial resources to meet the needs of socio-economic development, ensures generation of funds at the levels of state budgetary system and spending thereof according to the principles of urgency, repayment and serviceability. The regulatory function of government loan is discharged when the state, entering into loan relationship, affects the condition of monetary circulation, the level of interest rates on the capital market, production and employment. The control function of government loan lies in ensuring full and timely repayment of debt and the efficient use of borrowed funds.

A significant part of scientific works of Ukrainian academic economists is devoted to study of domestic government debt in terms of macroeconomic regulation processes.

In the works of V. Fedosov (2004) the domestic government debt is defined as the amount of outstanding domestic government loans at a particular time.

O. Prutska (2010, p. 9) believes that domestic government debt expresses the economic relations between the borrowing state and its creditors in terms of redistribution of borrowed capital and GDP of the borrower. Such economic relations are relations of secondary distribution of gross domestic product and national income which involve only a portion of proceeds and funds generated
at the stage of primary distribution, in particular, temporarily available funds of individuals and legal entities and population not intended for current use.

V. Kudriashov (2008), I. Lunina (2006) define the domestic government debt as an indebtedness of the state against lending transactions; obligations of the state regarding domestic loans remaining upon deduction of repaid portion thereof; the amount of accumulated during previous years state budget deficits less its positive balance.

V. Oparin (2005) believes that domestic government debt is associated with financing of government expenditure by individuals and legal entities in national currency; it has no significant negative impact on the economy, since it is not accompanied by export abroad of tangible assets; functionality of domestic government debt is redistribution of financial resources within the national economy.

According to T. Yefymenko (2012) and Y. Zhalilo (2009), the domestic government debt is the total amount of indebtedness of the state against outstanding domestic debt and unpaid interest thereon. At the same time, the specificity of domestic debt relations in the course of attraction and placement by the state of financial resources of individuals and business entities is determined by the principles of voluntariness, urgency and repayment.

Conclusions and prospects for further research

Thus, the dialectics of scientific approaches to defining the essence of domestic government debt proves the lack of a unified opinion regarding the nature of impact of domestic government debt on the economy of the state and the multi-vector nature of such impact. On the one hand, there is a market liberalism at which the domestic government debt as a tool of macroeconomic regulation is seen as a negative factor. In this case, the preference is given to the complete abandonment of financing budget expenditures through domestic government debt.

Scientific positions of national and foreign scientists are reduced to the consideration of domestic government debt in two ways – capital and current domestic government debt. The total amount of assumed and outstanding domestic government liabilities, including interest payments, make up capital debt. Upcoming expenses for income payment to creditors against all domestic debts of the state and repayment of domestic debts which maturity became due make up current debt.

Major positions developed in the world practice regarding regulation of the dependence between the increase in the domestic government debt and economic growth reduced to the fact that the higher the economic growth and the lower the actual interest rates, the more efficient the use by the state of domestic debt instruments to finance budget expenditures. These positions became the basis for determining the main functions of domestic government debt, in particular:

- government loan function – redistribution of financial resources in accordance with the needs of the economy and the expediency of supporting the socio-economic area, which involves formation of monetary funds at the levels of budget system of the state and spending thereof on the principles of urgency, repayment and serviceability;
- regulatory function – is discharged when the government, entering into loan relationship, affects the condition of monetary circulation, the level of interest rates on the capital market, production and employment;
- replacement function – increasing the amounts of domestic borrowings to finance budget deficit during recession, when there is an increasing gap between tax revenues and government expenditure (increase in the domestic government debt replaces the increase in tax revenues);
- control function – ensuring full and timely repayment of domestic government debts and the efficient spending of borrowed funds.

In our opinion, in modern conditions of economic development of Ukraine domestic government borrowings should be considered not only in terms of raising funds of individual and institutional investors, but also as a mechanism of regulation of monetary circulation, influence on the development of the capital market, impact on budget process. According to our scientific position, aspects of macroeconomic regulation in the mechanism of domestic government debt are caused by the following:

- from a macroeconomic point of view, monetary aspect of domestic government debt is of importance, since the amount of domestic government debt reflects the value of future (not yet received) monetary income of the state which it has already spent;
- availability of domestic government debt is permanent, since the practice of refinancing of government debts of earlier issues is possible through issuance of new government borrowings;
a real form of domestic government borrowings is domestic government liabilities which are the specific form of capital and financial instruments of domestic debt policy.

The specificity of the state capital is determined by the mechanism of yield formation. Thus, if in the private forms of capital the source of income is value added, then in the government capital the percentage of capital is generated from the state revenue, that is the government capital is almost not involved in the creation of value added, although reflects its redistribution. Monetary resources received by the state are directed to budget financing. The source of interest payment against domestic government debt and debt repayment are state budget income – tax and non-tax revenues. The holder of domestic government liabilities becomes the owner of a portion of future government revenue.

The main factor of creating the domestic government debt is the state budget deficit. The mechanism of domestic government borrowings, together with the mechanisms of taxation and currency issue (monetization) provides financing of government expenditure.

It should be noted that the increase in government revenue due to the growth of the tax rate means a reduction of aggregate incomes of business entities, which reduces the investment activity, thus helping to reduce the demand for labor, leading to an increase in unemployment level and decline in production. Coverage of the state budget deficit through currency issue creates a significant inflationary pressure on the economy and disrupts financial and macroeconomic stability.

Financing the budget deficit through the mechanism of domestic government borrowings is also not completely safe, the growth of domestic government debt may have the same effects as the increase in tax rates and currency issue, however, the time lag between the borrowings and their effects leaves some freedom of macroeconomic maneuver to the state.

The results of studying the essence of the category of domestic government debt prove that its substantive content is limited to the amount of indebtedness and the cost of servicing the domestic government debt. At the same time, a significant amount of scientific research of national and foreign authors confirms a significant influence of domestic government debt on the efficiency of macroeconomic regulation processes. In this regard, we consider it appropriate to clarify the definition of the category of “domestic government debt”, given current condition and prospects of development of the Ukrainian economy.

Our scientific position lies in that, in terms of macroeconomic regulation, the domestic government debt is an indebtedness of public authorities formed as a result of formation of financial resources of the country through borrowing monetary funds from individuals and private sector institutions, the target destination of which is mitigating contradictions between the economic and social needs of the society.

Thus, studies of the essence of the “domestic government debt” concept are closely related to the feasibility study of the state intervention in the regulation of economic processes and the efficiency of methods of financing government expenditure, the main scientific idea of which is reduced to the definition of conditions of choice between financing through tax, issuance and lending mechanisms.

References