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INTERNAL PUBLIC DEBT IN MACROECONOMIC REGULATION

This paper studies the role of the internal public debt in macroeconomic regulation. It is proved that formation, maintenance and repayment of domestic public debt largely determines the state of public finances, currency circulation, investment climate and consumption patterns. It is proved that efficiency of mechanism of internal government loan is determined by conditions of choosing between financing through the tax, share and state credit mechanisms. It is proved that efficiency of managing the internal state debt of Ukraine in the context of macroeconomic regulation depends on the volume of total expenditures and effectiveness of the state fiscal and tax policy tools.

Key words: domestic debt policy, domestic public debt, internal government borrowing mechanism, debt burden, state budget, state budget deficits financing, macroeconomic regulation, aggregate expenditures, tax policy.

Problem statement. Domestic public debt plays a multifaceted role in macroeconomic regulation, since its formation, servicing and repayment largely determine the state of public finances, monetary, investment climate and consumption patterns. The cause of the domestic public debt is the unbalanced fiscal policy of the state. At the same time, the global practice shows that the domestic public debt is an integral part of the vast majority of financial systems and the source of financing the budgetary expenditures with a view to promote the social and economic development of the state.

Studies of domestic government loans mechanism are closely related to the feasibility study of state intervention in economic processes regulation and effectiveness of the public expenditure financing methods, the core scientific idea of which comes down to determination of conditions of choosing between financing through tax, share and credit mechanisms, which justifies the relevance of the study subject in this article.

Analysis of recent research and publications. The problems of internal public debt mechanism functioning and its impact on socio-economic development of a state are considered in scientific papers of foreign and domestic economic scholars, namely J. Buchanan, J. Keynes, A. Lerner, E. Hansen, S. Harris, T. Efyomenko, Ya. Zhalilo, I. Liutyi, A. Moldovan, A. Sokolovska¹ etc. Despite plenty of findings of

¹ Buchanan, J.M. (1967). *Public Finance in Democratic Process: Fiscal Institutions and Individual Choice*. <<http://oll.libertyfund.org/titles/buchanan-the-collected-works-of-james-m-buchanan-vol-4-public-finance-in-democratic-process>>; Buchanan, J.M. (1958). *Public Principles of Public Debt: A Defense and Restatement*. <<http://oll.libertyfund.org/titles/279>>; Кейнес, Дж. (2012). *Общая теория занятости, процента и денег*. Москва; Keynes, J.A. (1924). *Tract on Monetary Reform*. London, 220.; Keynes, J.A. *The General Theory of Employment, Interest and Money*. <<https://www.marxists.org/reference/subject/economics/keynes/general-theory>>; Lerner, A.P. (1943). *Functional Finance and the Federal Debt*. <<http://fullemployment.info/money-and-macro/functional-finance-and-the-federal-debt>>; Lerner, A.P. (1961). *The Burden of Debt*. *The Review of Economics and Statistics*. Vol. 43, № 2, 139-141.; Lerner, A.P. (1948). *The Burden of the National Debt*. *Employment and Public Policy*, 255-275. <<http://socialdemocracy21stcentury.blogspot.com/2012/10/lerner-on-burden-of-national-debt.html?m=1>>; Hansen, A.H. (1943). *Fiscal Policy and Business Cycles*. *The Economic Journal*. Vol. 53, 209, 107-111. <<http://www.jstor.org/stable/2226302>>; Hansen, A.H. (1951). *Fiscal problems of Germany*. *Karlsruhe: Ministry of Finance of the Federal Republic of Germany*, 446; Harris, S.E. (1931). *Monetary problems of the British empire*. New York, 569.; Harris, S.E. (1950). *The National Debt and the New Economics*. *The Economic Journal*. Vol.60, № 237, 133-135. <<http://www.jstor.org/stable/2227220>>; Єфіменко, Т.І. (2012). *Фіскальний простір антикризового регулювання*. Київ: ДННУ «Академія фінансового управління»; Жаліло, Я.А. (2009). *Теорія та практика формування ефективної економічної стратегії держави*. Київ.; Лютий, І.О. (2008). *Державний кредит та боргова політика України*. Київ.; Молдован, О. Аналітична записка «Щодо оптимізації боргової політики держави». <<http://www.niss.gov.ua/articles/783>>; Соколовська, А.М. (2011). *Дискусійні питання реформування ПДВ*. *Фінанси України*. Вип. 8, 35-50.; Соколовська, А.М. (2012). *Податкова політика в Україні в контексті тенденцій реформування оподаткування у країнах ЄС*. *Фінанси України*. Вип. 1, 94-115.

scientific research of the economic nature of domestic public debt and its impact on effectiveness of macroeconomic regulation, the controversy on the subject of domestic public debt influence on economic development does not lose its relevance, particularly in times of economic and financial crises. This problem is still relevant from the point of view of research findings' adaptation to the conditions of Ukrainian economy development.

The aim of the article is to determine the effect of domestic public debt on effectiveness of macroeconomic regulation in Ukraine.

Key study findings. The role of domestic public debt in macroeconomic regulation is substantiated in a new orthodox theory of J. Keynes¹. The most prominent representatives of the "new economists" trend, "the Keynesians" are E. Hansen² S. Harris³, and A. Lerner⁴.

In contrast to the concept of a balanced budget and classical ideas about the undesirability of financing the budget deficit associated with military spending or recession with monetary issue, issue of government securities and taxation aggravation, the central tool of Keynesian macroeconomic policy, which aims at increasing the aggregate demand in times of economic downturns resulting from inability of the market economy to achieve a sustainable full employment, is the budget deficit financed by issue of government securities.

In the view of Keynesians⁵, the consumers feature a very high propensity to consume due to use of the current available income, so the tax reduction has an immediate and significant impact on aggregate demand, increasing the same. In the Keynesian model, the aggregate demand is supposed to be stimulated by reduced taxes and increased government spending, financed by the growth of the public debt; meanwhile, it is assumed that additional funds available to the household after tax cuts will be partially directed for additional consumption, and partially for savings, at the expense of which the public debt will be financed.

If the economy is in a state of underemployment, the increased consumption due to the multiplier effect increases the production and employment rates. In this case, deficits stimulate production and national income, savings and capital accumulation are not experiencing negative impact of budget deficits.

According to this approach, in a closed economy, at full employment with a fixed population, the initial burden of any public expenditure exists only within the period in which the expenditure is incurred. The real resources drawn from the private sector make up the true value of expenditure, and the burden of the expenditure program is limited to the period of spending. Thus, the cost financing by debt does not lead to displacement of real resources from the future into the present and the taxes needed to pay interest do not

¹ Кейнес, Дж. (2012). *Общая теория занятости, процента и денег*. Москва.; Keynes, J.A. (1924). *Tract on Monetary Reform*. London, 220.; Keynes, J.A. *The General Theory of Employment, Interest and Money*. <<https://www.marxists.org/reference/subject/economics/keynes/general-theory>>.

² Hansen, A.H. (1943). *Fiscal Policy and Business Cycles*. *The Economic Journal*. Vol. 53, № 209, 107-111. <<http://www.jstor.org/stable/2226302>>; Hansen, A.H. (1951). *Fiscal problems of Germany*. Karlsruhe: *Ministry of Finance of the Federal Republic of Germany*, 446.

³ Harris, S.E. (1931). *Monetary problems of the British empire*. New York, 569.; Harris, S.E. (1950). *The National Debt and the New Economics*. *The Economic Journal*. Vol.60, №237, 133-135. <<http://www.jstor.org/stable/2227220>>.

⁴ Lerner, A.P. (1943). *Functional Finance and the Federal Debt*. <<http://fullemployment.info/money-and-macro/functional-finance-and-the-federal-debt>>; Lerner, A.P. (1961). *The Burden of Debt*. *The Review of Economics and Statistics*. Vol. 43, № 2, 139-141.; Lerner, A.P. (1948). *The Burden of the National Debt*. *Employment and Public Policy*, 255-275. <<http://socialdemocracy21stcentury.blogspot.com/2012/10/lerner-on-burden-of-national-debt.html?m=1>>.

⁵ Кейнес, Дж. (2012). *Общая теория занятости, процента и денег*. Москва.; Buchanan, J.M. (1958). *Public Principles of Public Debt: A Defense and Restatement*. <<http://oll.libertyfund.org/titles/279>>; Hansen, A.H. (1943). *Fiscal Policy and Business Cycles*. *The Economic Journal*. Vol. 53, №209, 107-111. <<http://www.jstor.org/stable/2226302>>; Harris, S.E. (1950). *The National Debt and the New Economics*. *The Economic Journal*. Vol.60, №237, 133-135. <<http://www.jstor.org/stable/2227220>>; Keynes, J.A. (1924). *Tract on Monetary Reform*. London, 220.; Keynes, J.A. *The General Theory of Employment, Interest and Money*. <<https://www.marxists.org/reference/subject/economics/keynes/general-theory>>; Lerner, A.P. (1943). *Functional Finance and the Federal Debt*. <<http://fullemployment.info/money-and-macro/functional-finance-and-the-federal-debt>>; Lerner, A.P. (1961). *The Burden of Debt*. *The Review of Economics and Statistics*. Vol. 43, № 2, 139-141.; Lerner, A.P. (1948). *The Burden of the National Debt*. *Employment and Public Policy*, 255-275. <<http://socialdemocracy21stcentury.blogspot.com/2012/10/lerner-on-burden-of-national-debt.html?m=1>>.

involve spending of real resources. It should be noted that the supporters of the new orthodox approach recognized that debt creates certain difficulties for future generations, i.e. secondary (friction) burden, but it is considered insignificant.

From the viewpoint of D. Buchanan¹, new orthodox ideas of the public debt are based on three main statements, i.e. public debt creation does not imply any shifting of the primary real burden to the future generations; analogy between personal or private debt and public debt is wrong in all material respects; there is a clear and significant difference between domestic and external public debt.

Analogy between the public and private finance adopted from the "classical" economists is recognized by Keynesian economists is absolutely erroneous, especially in the context of the role of internal public debt in macroeconomic regulation. Thus, S. Harris believes that parallelism of private and public finance is false, and the appropriate analogy is inconsistent². E. Hansen argues that the domestic public debt is not like the private debt and does not have any essential feature of the private debt³.

Thus, the conceptual feature of the new orthodox school is to identify the methods for efficient public debt management, based on the differences between public and private finances. However, in terms of consumption, the state and business entities do have a lot in common; they tend to distribute the available income by various types of costs so as to obtain the greatest possible economic and social impact. For the state, it is no less important that the costs were reasonably limited than for an individual. However, in terms of production, employment and income, the parallel between the country's economy and the economies of individual households leads to erroneous conclusions. The principle of profit maximization can not be realized by the state similar to the households. The optimal financial condition of households is achieved, provided that their costs are lower or at least equal to revenues. For the state, the increased spending usually leads to increased gross national income and improved country's financial condition.

The impact of the economic activities of the business entities on the macroenvironment, mesoenvironment and microenvironment is significant only when the result affects their income and expenses, which determines the policy of private finance. The public financial policy effectiveness is determined solely on the basis of the impact of spending, tax and borrowing on the aggregate national income and its distribution. Consequently, the financial transactions of the state, i.e. monetary costs, collection of taxes, issue of loans and monetary issue, establishment of interest rates and prices of goods and services controlled by the state are not economic decisions made to balance the state budget. Achievement of this balance is not indicative of the state financial policy effectiveness, the aim of which is to achieve a "balance of the economy in general", i.e. economic and social development⁴.

Supporters of the new orthodox school⁵ argued that the effective domestic public debt management depends on the state's ability to maintain the value of total expenditure for goods and services at the level at which, at current prices, it was possible to sell the entire national output. At the same time, the aggregate expenditures above this level generate inflation, and below this level – unemployment.

The methods of increasing the aggregate expenditures are to increase the budget spending and to cut

¹ Buchanan, J.M. (1967). *Public Finance in Democratic Process: Fiscal Institutions and Individual Choice*. <<http://oll.libertyfund.org/titles/buchanan-the-collected-works-of-james-m-buchanan-vol-4-public-finance-in-democratic-process>>; Buchanan, J.M. (1958). *Public Principles of Public Debt: A Defense and Restatement*. <<http://oll.libertyfund.org/titles/279>>.

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³ Hansen, A.H. (1943). Fiscal Policy and Business Cycles. *The Economic Journal*. Vol. 53, №209, 107-111. <<http://www.jstor.org/stable/2226302>>.

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⁵ Hansen, A.H. (1951). Fiscal problems of Germany. *Karlsruhe: Ministry of Finance of the Federal Republic of Germany*, 446.; Harris, S.E. (1931). *Monetary problems of the British empire*. New York, 569.; Lerner, A.P. (1943). *Functional Finance and the Federal Debt*. <<http://fullemployment.info/money-and-macro/functional-finance-and-the-federal-debt>>; Lerner, A.P. (1961). The Burden of Debt. *The Review of Economics and Statistics*. Vol. 43, №.2, 139-141.; Lerner, A.P. (1948). The Burden of the National Debt. *Employment and Public Policy*, 255-275. <<http://socialdemocracy21stcentury.blogspot.com/2012/10/lerner-on-burden-of-national-debt.html?m=1>>.

the taxes as result of increased aggregate demand. Reduction of the total expenditure contributes to reduction of budget expenditures and tax increases as a result of aggregate demand reduction.

However, the volume of budget expenditures can be less than the tax revenue volumes and vice versa. In the first case, the difference can be used to pay off the public debt, and the second, it becomes necessary to cover the difference by loans and monetary issue¹.

The fundamental principles of the state tax policy, in the context of domestic public debt impact on macroeconomic regulation, are discussed in scientific papers of A. Lerner². The author formulated the principles of functional finance, according to which it is strictly forbidden to strengthen the tax burden in order to increase the budget expenditures. According to the scientific position of A. Lerner, the result of implementation of the state tax policy should be the reduced aggregate expenditures by reduction of taxpayers' money, while increasing the tax component of the budget revenues.

We agree that such a tax policy is feasible only when the future aggregate expenditures must be reduced to prevent the inflation growth. At the same time, according to the functional finance principles, the effect of the tax tools is significantly enhanced by increased volume of the domestic public debt by replacing the cash with government bonds. This classical scientific position is maintained in the studies of the tax policy impact on economic development by modern Ukrainian economic scholars, in particular T. Efimenko³, A. Sokolovska⁴, I. Liutyi⁵, O. Moldovan⁶, and Ya. Zhalilo⁷.

In Ukraine, from 1996 to 2014, the aggregate expenditures show a strong tendency to exceed the GDP (Fig. 1), which must be accompanied by increased inflation and reduced unemployment. However, there is a volatile dynamics of the consumer price index and the industrial producer price index, which, according to the results of the trend analysis, is characterized by a decrease in inflation, which proves a controversial macroeconomic effect. At the same time, the unemployment rate from 1996 to 2014 has been reduced insignificantly, which is not contrary to the provisions of a new orthodox theory about the influence of domestic public debt on the macroeconomic regulation processes. Besides, despite the crisis in the Ukrainian economy, GDP is increasing continuously. Thus, it implies an inefficient and instable financial system of the state, subject to simultaneous availability of productive capacities for economic development.

In such circumstances, is it required to reduce the aggregate expenditures through the use of fiscal and tax policy tools, in particular budget cuts and tax increases. However, the budget expenditures in 1996-2014 have been increasing continuously in proportion to the aggregate expenditures (see Fig. 1). At the same time, the tax levers have been used actively, which led to an increase in tax revenues to the state budget 1.67 times from 2008⁴ to 2014, from UAH 167.9 billion in 2008 to UAH 280.2 billion in 2014 (Fig. 3). The basis of tax revenues was the value added tax, personal income tax and corporate income tax; their

¹ Кейнес, Дж. (2012). *Общая теория занятости, процента и денег*. Москва.; Buchanan, J.M. (1967). *Public Finance in Democratic Process: Fiscal Institutions and Individual Choice*.

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³ Єфіменко, Т.І. (2012). *Фіскальний простір антикризового регулювання*. Київ: ДНУ «Академія фінансового управління».

⁴ Соколовська, А.М. (2011). Дискусійні питання реформування ПДВ. *Фінанси України*. Вип. 8, 35-50.;

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оподаткування у країнах ЄС. *Фінанси України*. Вип. 1, 94-115.

⁵ Лютий, І.О. (2008). *Державний кредит та боргова політика України*. Київ.

⁶ Молдован, О. Аналітична записка «Щодо оптимізації боргової політики держави».

<<http://www.niss.gov.ua/articles/783>>.

⁷ Жаліло, Я.А. (2009). *Теорія та практика формування ефективної економічної стратегії держави*. Київ.

shares are the largest in the tax revenue structure. However, the result of the tight fiscal policy is manifested only in increase of the tax revenues to the state budget of Ukraine, but has no effect on the amount of aggregate expenditures. The structure of revenues of the state budget of Ukraine is shown in Fig. 2.

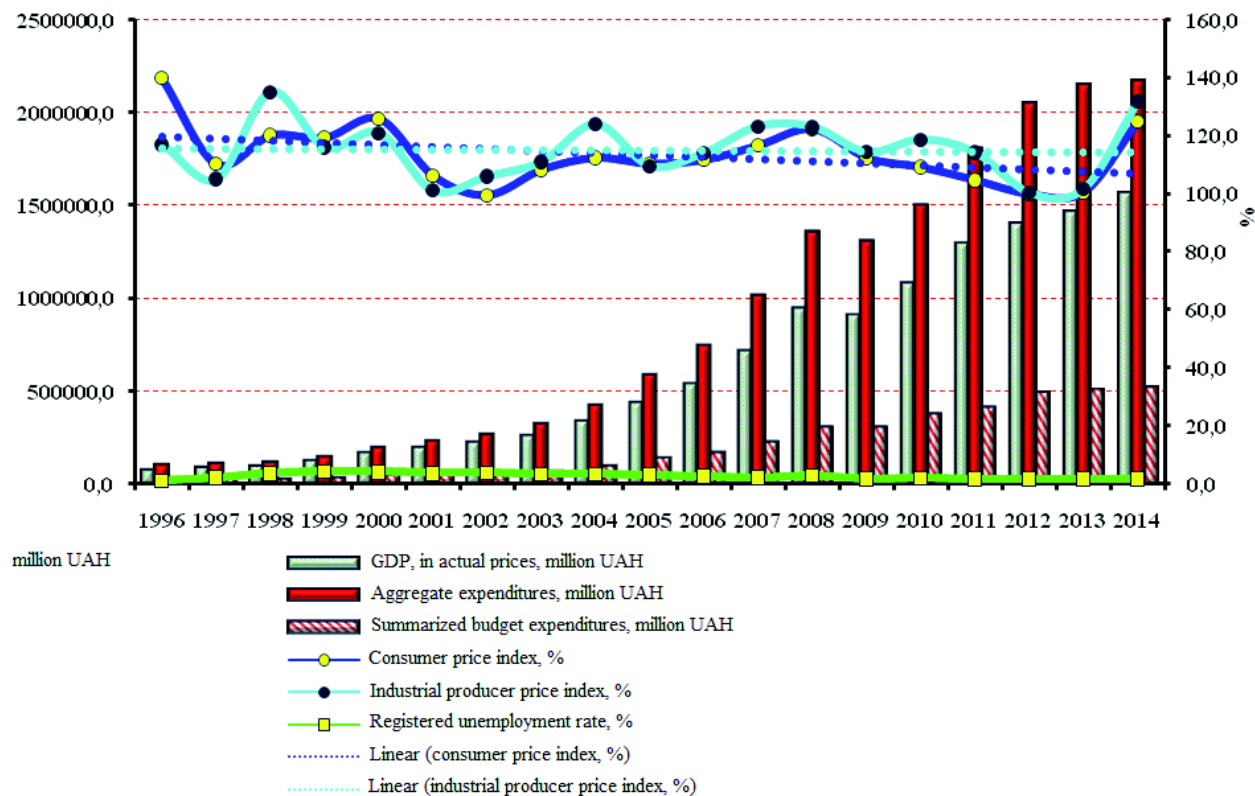


Fig. 1. Dynamics of cumulative expenditures, GDP, budget expenditures, inflation and unemployment rates in Ukraine in 1996-2014.

Source: compiled by the author based on official data from the National Bank of Ukraine¹ and the State Treasury Service of Ukraine².

We'd like to note that during 2008-2014, the annual volume of the Ukrainian state budget expenditure has significantly exceeded the volume of tax revenues to the state budget (Fig. 3); the average excess for the period is 1.52 times. As a result of this trend, there is an objective need to cover the difference by increasing the volume of domestic public debt and monetary issue. Thus, the volume of domestic public debt increased 10.32 times (from UAH 44,666.55 million in 2008 to UAH 461,003.62 million in 2014), and the money supply increased 1.86 times (from UAH 515,727.00 million in 2008 to UAH 956,728.00 million in 2014).

Besides, the share of tax revenues in the structure of revenues of the consolidated state budget of Ukraine in 2007-2014 ranged from 72.1% to 84.5% for the summarized budget, and from 68.4% to 84.4% for the state budget³, but this dynamics was not accompanied by a reduced volume of total expenditure and inflation rate (Fig. 1), since the increased tax pressure was accompanied by increased budget expenditures (Fig. 3), which is unacceptable in the context of aggregate expenditure reduction. At the same time, we believe that the tax policy tool effect considerably intensified the growth of domestic public loans.

¹ Офіційний сайт Національного банку України. <<http://www.bank.gov.ua>>.

² Офіційний сайт Державної казначейської служби України. <<http://treasury.gov.ua>>.

³ Офіційний сайт Інституту бюджету та соціально-економічних досліджень України. <<http://www.ibser.org.ua>>.

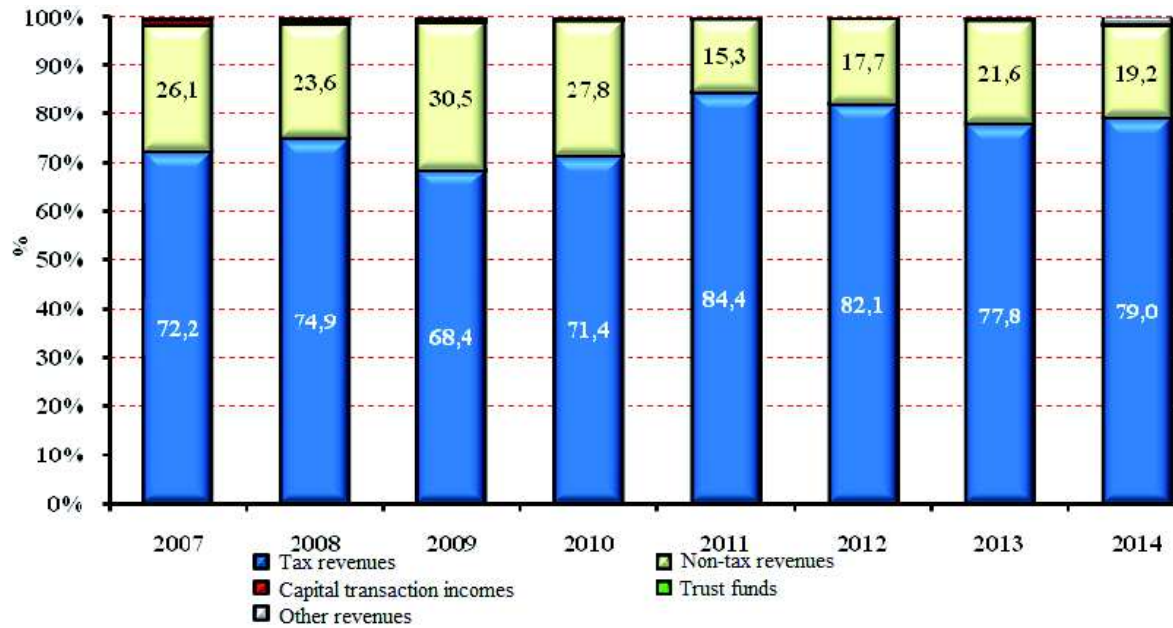


Fig. 2. Revenue structure of the State Budget of Ukraine.

Source: compiled by the author based on official data of the Institute of Budget and Socio-Economic Research of Ukraine¹.

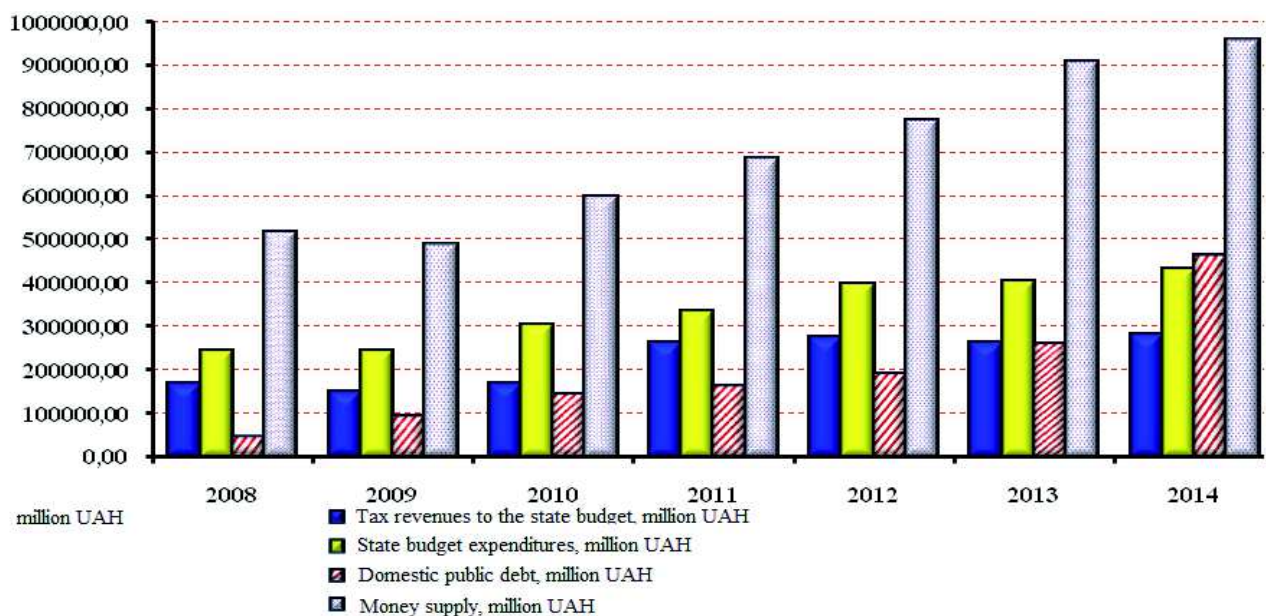


Fig. 3. Dynamics of tax revenues to the state budget, state budget expenditures, internal public debt and money supply in Ukraine in 2008-2014.

Source: compiled by the author based on official data of the Institute of Budget and Socio-Economic Research of Ukraine² and the National Bank of Ukraine³.

¹ Офіційний сайт Інституту бюджету та соціально-економічних досліджень України. <<http://www.ibser.org.ua>>.

² Офіційний сайт Інституту бюджету та соціально-економічних досліджень України. <<http://www.ibser.org.ua>>.

³ Офіційний сайт Національного банку України. <<http://www.bank.gov.ua>>.

Conclusions and prospects for further research. In our view, the influence of the domestic public debt on the macroeconomic regulation effectiveness is determined by the need to adjust the level of the aggregate expenditures in relation to GDP ratio with an appropriate volume of state budget expenditures and tax revenues to the state budget, in particular:

- 1) if the volume of state budget expenditures exceeds the tax revenues to the state budget, the internal public debt should increase, which will lead to reduction in aggregate expenditures;
- 2) if the volume of the state budget is less than the volume of tax revenues to the state budget, the internal public debt should be reduced (repaid), which will lead to an increase in aggregate expenditures.

It should be noted that, in the context of effective macroeconomic regulation, the determining factor is not the absolute value of the aggregate expenditures, but the deviation of their volumes from the respective GDP volumes, so the alternative way to minimize this deviation is to change in the volume of GDP, which implies the increase in GDP for the Ukrainian economy. In our opinion, the financial instrument of increasing the GDP volume in Ukraine is increasing the share of productive expenditure and development expenditures in the structure of state budget expenditures. Thus, the effectiveness of the domestic public debt management, in the context of macroeconomic regulation, depends on the volume of total expenditures and effectiveness of the state fiscal and tax policy tools.

We'd like to note that the monetary issue, reduction of the tax burden and repayment of domestic public debt are the tools of increasing the aggregate expenditures. If the implementation of the tax policy of the state, regulation of aggregate expenditures and management of the domestic public debt are conducted according to the functional finance principles, then any excess of the cash expenditures over incomes non-secured by the money reserve (cash, coins of precious metals) should be secured by monetary issue, and any surplus must be eliminated or used to replenish the cash reserves. In order to reduce the unemployment and inflation rates, in terms of an extremely low level of aggregate expenditures, the budget expenditures should be increased; in terms of an extremely high level of aggregate expenditures, the tax pressure should be increased. The effectiveness of domestic public debt management, in the context of loans and payments activity, shall be determined by maintaining such a level of interest rate which does not reduce the investment activity in the country. These provisions, respectively, determine the need for monetary issue, hoarding or withdrawal of money from circulation.

In terms of effective macroeconomic regulation, we share the scientific position that the financing of economic and social development by the budget deficit, suggesting the emergence or growth of the domestic public debt, can be a permanent and indispensable feature of modern economies. The size of domestic public debt has a relatively little significance at the level of macroeconomic regulation, as this debt includes both requirements and obligations. For holders of domestic government obligations, domestic public debt is an asset. The funds spent to pay the interest or principal will become income for lenders, so the volume of the national income will not be reduced. We'd like to note that for business entities, debt is solely an obligation. However, consideration of the mechanism of the domestic public debt as a counterpart of cash flows between accounts within the activity of an individual business entity is narrow and limited. Domestic government loans exercise a strategically important impact on the macroeconomic regulation of production and distribution of the national income.

Thus, at the level of macroeconomic regulation, domestic public debt is a management tool for formation and distribution of the national income. In terms of the modern economic development of Ukraine, the budget deficit acquired the form of a permanent (structural) deficit, regardless of the economic cycle phase, contrary to the classical ideas, according to which the existence of the fiscal deficit is an objective fact in terms of the economic downturn, and in terms of economic growth, there is a budget surplus.

The consequence of this tendency has become a steady increase in domestic public debt, resulting in increased cost of its maintenance; the process of displacement of private loans with government ones started, which in turn led to reduction of production investment and growth inhibition.

Our scientific position is that the volumes of domestic public debt should have the limits, the infringement of which affects the macroeconomic regulation efficiency. However, such limits should be determined not with a fixed amount or static macroeconomic situation, but in the dynamics, that is the determining factor shall be the rate of change in domestic government debt. We believe that the macroeconomic regulation effectiveness essentially depends on objectivity of determining the limits of internal public debt.

In our opinion, the imperatives of the domestic public debt management, in the context of effective macroeconomic regulation, is to regulate the volume of the aggregate expenditures by effective tools of the state fiscal and tax policy. At the same time, the efficiency of the domestic public debt management essentially depends on adequacy of the currency exchange rate regime, and effective monetary policy tools ensuring the price stability.

Ensuring the availability of the above imperatives will allow creating the structure of domestic public debt corresponding to the public needs, minimizing the financial system vulnerability to effects of the economic and financial crises' factors. We believe that the result of effective management of domestic public debt is trust of financial market participants and investment attractiveness of the domestic public debt instruments, which will be manifested in an increase of the share of domestic public debt in assets portfolios of institutional and private investors.

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