

development of the national stock market. Lack of resources of citizens and financial literacy in the country is also influencing negatively the pension funds popularity. High inflation and financial instability influences the assets of pension funds and trust of citizens to their activity.

At the same time, it is obvious, that is it important to develop pension system in Ukraine, as the burden on the state pension fund grows and the future income of pensioners is rather limited. Besides, as we can see from the international experience, the development of pension funds stimulates the investments on the financial markets.

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THE IMPACT OF PUBLIC DEBT ON THE ECONOMIC CONDITIONS OF THE COUNTRY AND ON ITS DEVELOPMENT

According to the data of Trading Economics nowadays the increase of public debt volume can be seen in many countries all over the world. Especially it gets higher with the more rapid pace in the developing countries. Since the emergence of public debt notion many scientists have been argued about an impact of this complicated phenomenon on those countries which have ones made a decision to attract some financial resources in this way and play the role of borrowers. On one side, an existence of significant public debt may jeopardize the economic development and negatively affect the financial

condition of the country. On the other – the public debt implies under itself an acquisition of additional funds, plays the role of the economic growth stimulating force and gives an opportunity to invest in the prospective industries and spheres. By attracting the public debt, and with the help of appropriate investing decisions, regulations and efficient usage of the financial resources, the governments can increase the production capacities of the country, national income and welfare of the citizens.

In accordance with the nature of economic consequences which the government liabilities can lead to, they can be divided on short-term and long-term ones. The short-term consequences reveal themselves in the displacement problem, the long-term ones are known as debt burden. An effect of displacement emerges as the result of refinancing the state budget deficit via providing new borrowings. Such financing leads to an increase of interest rates on the national market. Because of this, the credits for domestic economic entities become too expensive and non-lucrative for providing investment projects, thus, the investments in the real sector of the country start to displace from the market.

The long-term consequences of public debt are linked with its impact on the capital accumulation process and the future generation's consumption (long-term economic growth). The debt accumulation and an increase of interest rates on the domestic market in long run usually leads to the situation when the volume of investments in the private sector decreases while people start to place their saving into the government securities. Thus, because of the private investments' absence, the debt accumulation leads to a decrease in the manufacturing capacities of the country that, in turn, slows down the economic development and leads to the reduce of incomes. At the same time, if the debt management in the country is efficient, then it does not harm the economy, vice-versa, stimulates to even rapid development.

Overall, all consequences which the debt can lead to can be as positive, as negative. One of the main requirements that are needed to be fulfilled to ensure an economic growth of any country are investments. Without investments and a sufficient amount of money the country will be in stagnation with no opportunities of further development. Thus, for many countries, especially undeveloped and those, which are in the process of developing, the public debt is one of the few ways to accelerate the economic growth.

The effectiveness of public debt regulation can be estimated by the impact that is caused by debt on the economy. A general scheme of effective debt usage and its impact on the economy is shown on the Figure 1. The most effective usage of debt is to transform the funds borrowed in the investment in human capital and innovations. Such investments contribute to the emergence of scientific and technological progress which helps to develop business activity in intensive way instead of extensive one. As the result, the effectiveness of business activity increases, the need in new government loans decreases and country has more funds to invest in its further development. In addition, such dynamics in the issue of public debt makes the investment climate of the county better, that attracts more foreign investments and also has positive impact.

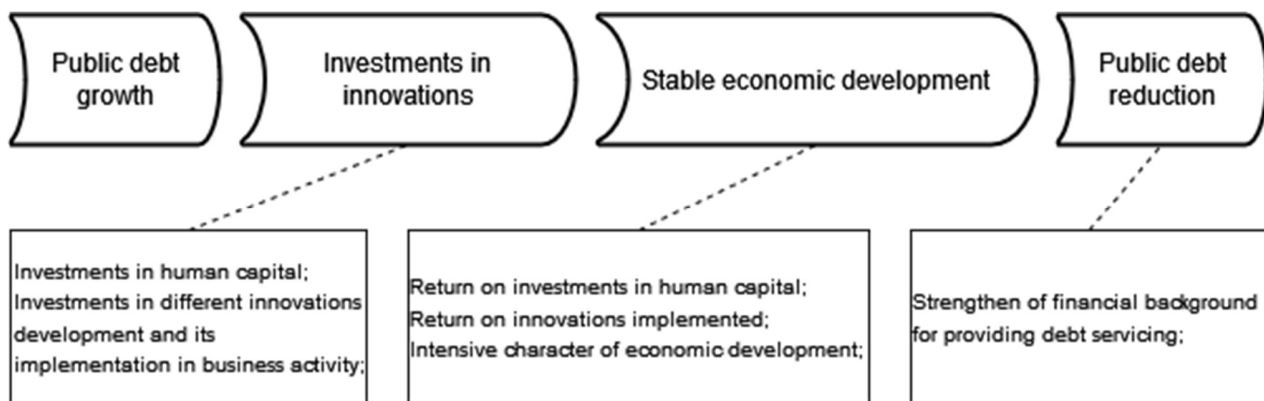


Figure 1. **A scheme of effective debt usage**

As it was already stated, the more preferable type of public debt for any country is an internal one due to the lower number of possible negative consequences which it may cause. The problem is that not in every country the population has free capital to invest in the domestic government bonds. Furthermore, even if it has, investing in the government bonds can be not very common among the residents because of the low trust to the country's authorities. Hence, if the government cannot attract the financial resources on domestic market, it is forced to invoke external borrowing.

The advantages of internal debt over an external are quite numerous. Firstly, in the case of internal borrowing the debtor (government of the country) can determine the conditions of funds lending by itself, even interest rates, while the external borrowing implies no possibility for borrower to somehow influence on the credit conditions establishing process. The lenders in the internal borrowing occasion do not have an impact on the borrower and cannot dictate the circumstances of crediting and debt repayment. This feature is characterized only for internal debt and gives all benefits to the debtor.

Secondly, an internal debt implies lower cost and, in addition, benefits from the absence of the foreign exchange risk. The thing is that the interest rates for the domestic government bonds are defined directly by the government of the country-borrower, consequently, the cost of such credits will be lower in comparison with those which have been granted by foreign lenders. Moreover, the currency market cannot be called stable and from the state's perspective it is much more safer to have liabilities in national currency rather than in foreign one in order to exclude a threat of debt increase because of the national currency depreciation.

Thirdly, the domestic government bonds issuing (or purchasing) can be provided by authorities as a monetary policy measure to regulate the inflation processes and stabilize a domestic financial market. With the help of internal borrowing the government can either expand (in case of deflation) or reduce (in case of inflation) the amount of money supply and influence the exchange rates on the currency market.

One more advantage is that the internal borrowing does not harm the country's independency on the world stage and its reputation. In contrast to the internal debt, the external one creates a strong dependance between the borrower and lender. In case of late repayment of the credit or its absolute absence, the foreign governments or international institutions have a right to apply the appropriate sanctions and restrictions in political or economic manner against the borrower that can blow up the stability of borrower's economy. In addition, in the context of business reputation, if the country is incapable to pay off its liabilities, then it starts to lose the trust of other entities, that instantaneously reduces the chances to receive a financial assistance in the future. At the same time, the prompt returning of funds shows that the borrower uses the funds in effective way and increases the assurance of the foreign lenders that the money invested in this country will pay off and be returned on time in case of future borrowings.

One more aspect of internal borrowing lies in the mutual benefit between the authorities and domestic economic entities. As the last ones play the role of creditors, the government becomes interested in the increase of their revenues, as well as in the business development, because the raise of income leads to the increase in individuals' and legal persons' capability to be a source of crediting.

Despite all the benefits that the public debt can bring, the threats of its usage can be very destructive and dangerous for the economy. Logically, all benefits of an internal borrowing which have been described above also serve as the disadvantages of external borrowing, but the list of threats that the foreign debt has is much longer.

The more developed economy the country has, the easier it is for this country to accumulate financial resources, pay back the funds it has borrowed and gain the trust from lenders, but still, even in occasion of successful credit repayment, external debt has a negative aspect – the capital outflow from the country (in the form of debt servicing).

For the undeveloped and developing countries everything is exact opposite. Such countries mostly have weak and unstable economies, which often have a chronic budget deficit, and it is hard for them to generate a sufficient amount of financial resources during the established by the credit contract period and fulfill its liabilities in time. Moreover, besides the credit itself, the payments regarding interest rates start to accumulate. Thus, in comparison with developed countries, the undeveloped and developing ones, firstly, borrow money for higher cost and, secondly, have lower productive capacities, as the result – the country is incapable to return the credit. The government starts to feel the need both in refinancing current liabilities and in financing the budget deficit. One of the measures which the government can take in this occasion is to increase taxes in order to receive more money in the form of tax revenues, but this has its own consequences – for example, an increase of tax avoidance and the raise of shadow economy, that will not lead to the greater government revenues and provoke even greater deficit.

The second option implies an attraction of money via internal borrowing – the government increases the interest rates of the domestic government bonds to make them

more beneficial for investors. But, this measure also can cause negative effect. If the bonds become more lucrative, then the investors will prefer to invest in them rather than in a private sector and it will slow down the pace of economic growth.

The third way is refinancing the old liabilities by new external borrowings. It means that the government take new credits, even with a higher cost, and provides a repayment of its previous borrowings. This serves as the point of the vicious circle appearance, or in other words – debt spiral initiation (Figure 2), and the debt starts to accumulate.

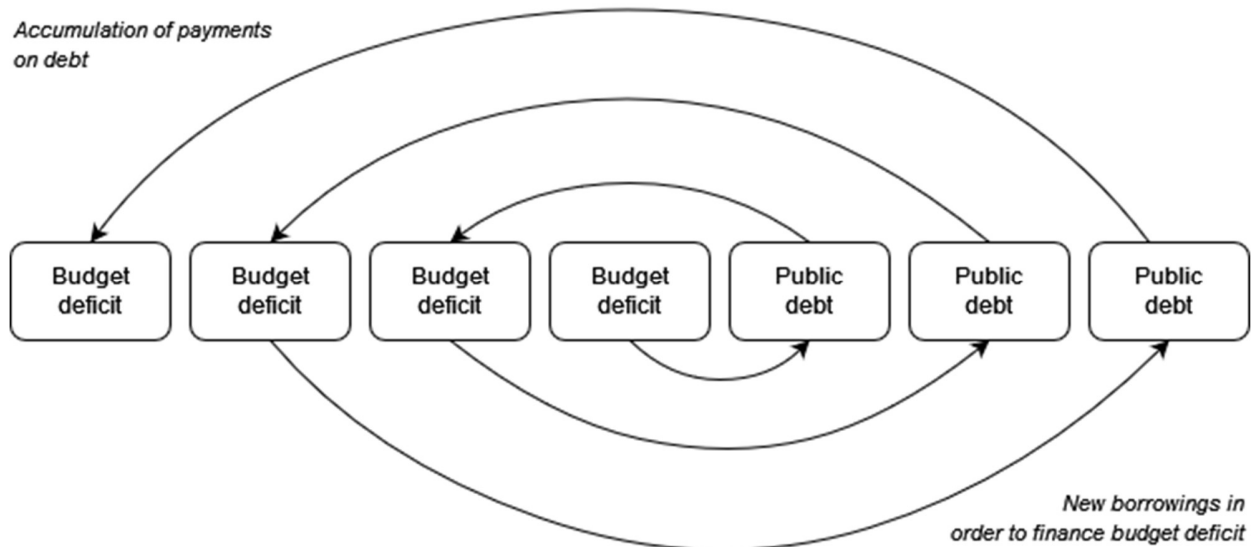


Figure 2. **The scheme of debt spiral**

So, the conclusion can be made that the best option while providing an external borrowing is to invest the money received in country's real sector rather than refinance previous liabilities. In this case the funds invested help to boost economy, the companies start to receive more profits. In the result, they have an opportunity to rise employees' wages and the purchasing power of the population increases, people spend more, and the economy develops with greater pace that allows to generate sufficient funds for the loan repayment in appropriate time boundaries and gain the trust on the world stage.

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