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**Nadiya Rushchshyn**  
PhD (Economics), Associate Professor,  
Lviv Trade and Economic University,  
10 Tuhan-Baranovskyi Str., Lviv,  
79005, Ukraine  
[nadiya\\_r@i.ua](mailto:nadiya_r@i.ua)



**Irina Buchko**  
PhD (Economics), Associate Professor,  
Lviv Trade and Economic University,  
10 Tuhan-Baranovskyi Str., Lviv,  
79005, Ukraine  
[buchko.ira@gmail.com](mailto:buchko.ira@gmail.com)



**Zoryana Kostak**  
PhD (Economics), Associate Professor,  
Lviv Trade and Economic University,  
10 Tuhan-Baranovskyi Str., Lviv,  
79005, Ukraine  
[kostakz@ukr.net](mailto:kostakz@ukr.net)

## Public debt of Ukraine: current status and options for its optimization

**Abstract.** There is an urgent need to decrease the size of debt in Ukraine, but instead recently the amount of public debt has been increasing and potential sources of debt repayment of the previous periods were reducing. Therefore, improvement of the efficiency of public debt management and search for optimization of state's external debts are major challenges. The research is aimed to assess current state of Ukraine's public debt, and to define tools that would allow to reduce it and to optimize international borrowing. The authors offer to use a system approach to debt management by providing the Committee on debt security management with major authorities in this area.

**Keywords:** Public and Publicly Guaranteed Debt; External Debt; Debt Management; Debt Security

**JEL Classification:** G31; G38

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### Руцишин Н. М.

кандидат економічних наук, доцент, Львівський торговельно-економічний університет, Львів, Україна

### Бучко І. Є.

кандидат економічних наук, доцент, Львівський торговельно-економічний університет, Львів, Україна

### Костак З. Р.

кандидат економічних наук, доцент, Львівський торговельно-економічний університет, Львів, Україна

### Державний борг України: сучасний стан та напрями оптимізації

**Анотація.** У статті розглянуто сучасний стан державного та гарантованого державою боргу, досліджено причини значного зростання заборгованості держави перед міжнародними фінансово-кредитними інституціями. Визначено чинники, які зумовили зниження спроможності до погашення зовнішнього боргу і призвели до зниження кредитного рейтингу України з боку Standard & Poor's Ratings Services. Запропоновано системний підхід до управління державним боргом країни задля підвищення ефективності використання міжнародних запозичень.

**Ключові слова:** державний та гарантований державою борг; зовнішній борг; управління державним боргом; боргова безпека.

### Руцишин Н. М.

кандидат экономических наук, доцент, Львовский торгово-экономический университет, Львов, Украина

### Бучко И. Е.

кандидат экономических наук, доцент, Львовский торгово-экономический университет, Львов, Украина

### Костак З. Р.

кандидат экономических наук, доцент, Львовский торгово-экономический университет, Львов, Украина

### Государственный долг Украины: современное состояние и направления оптимизации

**Аннотация.** В статье рассматривается текущее состояние государственного и гарантированного государством долга, изучены причины значительного роста задолженности государства перед международными финансово-кредитными институтами. Определены факторы, которые обусловили снижение способности государства к погашению внешнего долга и привели к снижению кредитного рейтинга Украины со стороны Standard & Poor's Ratings Services. Предложен системный подход к управлению государственным долгом страны с целью повышения эффективности использования международных заимствований.

**Ключевые слова:** государственный и гарантированный государством долг; внешний долг; управление государственным долгом; долговая безопасность.

### 1. Introduction

Currently Ukraine faces urgent need to decrease the size of public debt, as it continues its growth, and traditional sources of debt repayment are reduced. The negative trend of the state debt policy is defined by the fact that loans coming from international financial and credit institutions are not used for investment but to redeem state deficit and service previous

loans. Therefore, efficiency of public debt management and optimization of external debt is under revision.

### 2. Brief Literature Review

Many scholars contributed to the research of public debt management, among them such prominent economists as V. Allen (Allen, 2006) [1] and C. Freeman (Freeman, 1982) [2]. Geyets (1999), Plets (2014), Londar (2015), Nestoruk (2011)

studied the regulatory processes of public debt [3-6]. Borynets (2012), Makar (2012), Gedz (2015) focused on public debt dynamics in different countries [7-8, 17]. However, negative trends in national economy, such as GDP reduction, growth of inflationary processes and currency devaluation, crisis of domestic banking system, unfavorable investment climate unable to attract foreign investors, affect the state's debt security.

**3. Purpose**

We aim to study current state of Ukraine's public debt and to search for approaches to achieve state's debt reduction and optimization of international borrowing usage.

**4. Results**

In the situation of economy's institutional imbalances, and the growth of budget deficit and balance of payments, debt burden on internal and external borrowing increases. According to the Law of Ukraine «On the Foundations of Ukraine's National Security», debt security is such a level of internal and external debt, including the cost of its service and effectiveness of usage, that is sufficient to meet socio-economic needs, do not threat national sovereignty, nor jeopardize integrity of the domestic financial system [10]. In other words, the stimulating impact of public debt on the country's socio-economic development is clearly defined by current legislation. But reality do not meet legal provisions as International Monetary Fund - the major lender of Ukraine - forecasts the growth of Ukraine's gross public debt in 2016 up to 94% [15].

The public debt is the total amount of state's debt liabilities, including paying off received and non-redeemed credits (loans) as of the reporting date, arising as a result of government borrowing [13]. At present, the main purpose of state's borrowing is to finance budget deficit (in 2015 it equaled UAH 52 million according to Ministry of Finance of Ukraine, although it halved comparing to 2014) [13].

Ukrainian legislation treats public debt as consisted of direct and guaranteed debts:

- direct debt is the total amount of unconditional country's debt liabilities for received and non-redeemed to date credits (loans) that arise from government borrowing;
- publicly guaranteed debt is the total debt liabilities of business entities-residents of Ukraine on paying off received and non-redeemed to date credits (loans) guaranteed by the state [13].

By borrowing sources, public debt can be internal (state's debt to all citizens and legal entities - holders of domestic public bonds) or external (state's borrowing on the international market) (Figure 1).

The public debt structure since Ukrainian independence shows that the amount of the external debt exceeded the internal one [15], which leads to negative socio-economic consequences: payment of interests and main debt causes the outflow of foreign currency, which in turn reduce gold and foreign currency reserves, increase exchange rate of foreign currency to national currency, produce of hryvnia devaluation, etc.

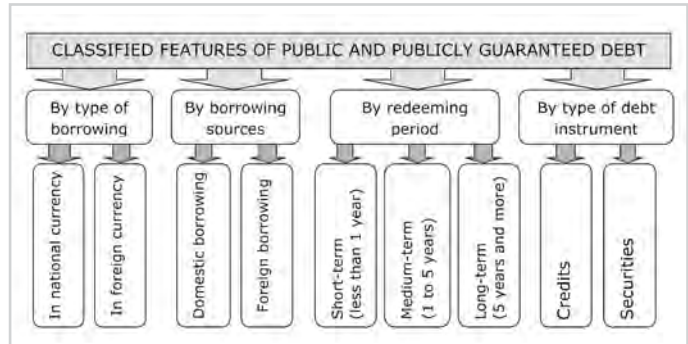


Fig. 1: Classified features of public and publicly guaranteed debt Source: [16]

The main indicator of the state's financial stability is its ability to fully service and repay public debt, which is crucial to the image of responsible and reliable borrower. Today most countries of the EU and United States are the most reliable borrowers as they have steady economies and good credit history. These countries are able to acquire loans on the best available terms on the market. The state of public and publicly guaranteed debt in Ukraine is dramatically different, while showing some positive dynamics in the last six years (see Table 1).

The bigger picture of Ukraine's public and publicly guaranteed debt demonstrates the rapid increase in debt burden - 263.6% for 2010-2015.

It should be noted that during this period the growth of both external public and publicly guaranteed debt is about twice as much as the increase in state's internal debt. In absolute terms, the total amount of public debt has increased by almost UAH 1,139 bln, moreover, the most rapid growth of public debt was observed in 2014-2015.

The negative trends in public and publicly guaranteed debt growth persisted at the beginning of 2016. On April 30, 2016 this indicator increased by UAH 118,016.26 mln compared to the end of 2015. Increase was both in public debt (by UAH 115,052.99 mln) and publicly guaranteed debt (by UAH 2,957.27 mln). Both hryvnia devaluation and significant increase in government borrowing are responsible for debt growth. Government borrowed, both internally and externally, to cover budget deficit, to service existing public debt, and to smooth negative effects of the financial crisis.

We agree with the evaluation by leading financial market experts [5, 7] that currently national economy is in the middle of several major crises in political, economic, financial and banking sectors. The military conflict in eastern Ukraine, along with accrued in previous years macro-economic imbalances, have destroyed the state's macro-financial stability. The fact that in 2014 the volume of international currency reserves in Ukraine decreased to USD 7.5 bln proves this. Further drop in gold and

Tab. 1: Dynamics of Ukraine's public and publicly guaranteed debt for 2010-2015, mln UAH

Indices/Years	2010	2011	2012	2013	2014	2015	Deviation (+,-), 2015-2010.	Growth rate, % 2015-2010
1. Total amount of public and publicly guaranteed debt, including:	432,303.27	473,185.18	515,510.83	584,786.57	1,100,833.22	1,571,765.64	1,139,462.37	263.6
1.1. Public debt, including:	323,475.42	357,273.87	399,218.23	480,218.63	947,030.47	1,333,860.71	1,010,385.29	312.3
- internal debt	141,662.10	161,467.01	190,299.30	256,959.58	461,003.62	508,001.12	366,339.02	258.6
- external debt	181,813.32	195,806.86	208,918.94	223,259.05	486,026.85	825,859.59	644,046.27	354.2
1.2. Publicly guaranteed debt, including:	108,827.85	115,911.32	116,292.6	104,567.94	153,802.75	237,904.93	129,077.08	118.6
- internal debt	13,895.4	12,303.19	16,211.42	27,129.15	27,863.28	21,459.45	7,564.05	54.4
- external debt	94,932.46	103,608.12	100,081.18	77,438.79	12,593.46	216,445.47	121,513.01	127.9
2. GDP	1,082,569	1,316,600	1,408,889	1,454,931	1,566,728	1,979,458	896,889	82.8
3. Total amount of public and publicly guaranteed debt / GDP, %	40.0	35.9	36.6	40.2	70.3	79.4	39.3	98.5

Source: Compiled by the author based on [13]

foreign currency reserves to USD 5.6 bln on January 3, 2015 was all time low since June 2003, while the minimum statutory gold and foreign currency reserves (to cover total amount of imports for three months) should be around USD 23 bln [13]. Dramatically shrinking reserves, in turn, decreases government capabilities to paying off external debt, and led to the deterioration in Ukraine's credit rating by Standard & Poor's Ratings Services down to the level «CCC-». However, in February 2015 Ukraine's short-term credit rating in foreign currency at «C» level was confirmed [5]. On March 24, 2015 Moody's Investors Service also downgraded the ratings by long-term liabilities in both foreign and national currency from «Caa3» to «Ca», and kept a negative forecast [5].

Another significant socio-economic index is the value of public and publicly guaranteed external debt per capita and per working citizen. The index dynamics in Ukraine for 2010-2015 is shown in Figure 2.

Figure 2 shows steady growth of all indicators, as they reached their maximum value on January 01, 2016. Thus, the amount of publicly guaranteed external debt per capita and per working citizen in 2015 amounted to UAH 5,042 and UAH 13,105 respectively. This is the product of further decrease of total population in Ukraine, its aging and constant growth of government borrowing.

To find the main reasons behind Ukraine's increased debt, we have to address factors that negatively affect the public debt status, namely: factors of direct impact and factors of indirect impact (see Table 2).

An important indicator of state's debt security is the ratio of public debt to GDP. According to the Budget Code of Ukraine, the main body of the debt should not exceed 60% of the actual annual GDP [11].

However, the data in Table 1 show that the ratio index of public debt to GDP in 2010-2015 had positive dynamics and reached highest value in 2015 - 79.4%, which exceeds the legal provision by almost 20%.

This situation produce further increase in debt insecurity, and threatens future cooperation of international financial and credit institutions with Ukraine.

One of the major challenges for the debt policy of Ukraine is to balance tax financing of budget expenditures. Short-term borrowing creates an opportunity to reduce fiscal burden on the economy, and to push businesses to increase investments in their own development. But as financing of current budget expenditures will be carried out at the expense of future generations that may cause slower economy's development in a long run.

In order to boost the socio-economic development of the state it is necessary to take a number of steps, namely: to monitor and control the volume of budget deficit and the level of debt security; to intensify investments in the country by promoting favorable investment climate. By acquiring additional financial resources to the country, government stimulates the economic growth, and investment into national economy not only with its own internal resources. However, public debt along with excessive government spending, budget imbalance and failures in the monetary policy may lead to financial crises and limit investment activity in the country.

Thus, public debt itself is an ambivalent economic factor, as it can either contribute to national security or be a source of financial threats and risks. That is why it

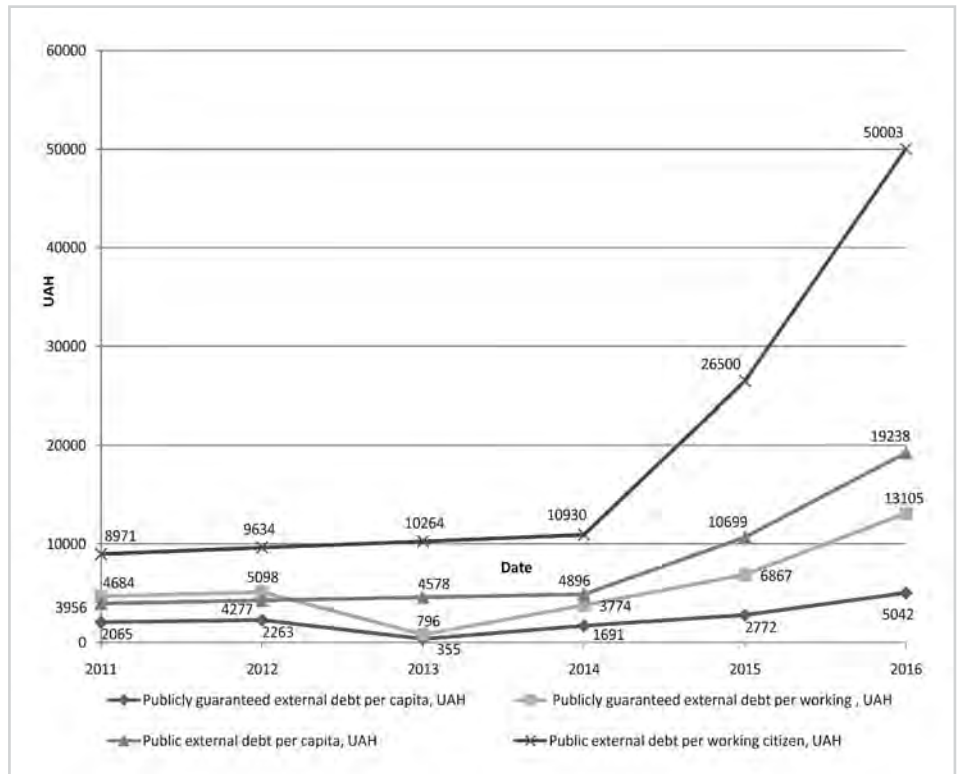


Fig. 2: Dynamics of Ukraine's public and publicly guaranteed external debt per capita and per working citizen for 2010-2015  
Source: [13]

is important to elaborate such strategy of public debt management that will enable effective usage of international borrowing and facilitate the optimization of debt burden [16].

For the purpose of effective public debt management we propose to introduce system approach (see Figure 3).

Thus, an important requirement should be efficiency of credit resources spending and investment focus of their use, which will contribute to gradual economic growth and reduction in country's financial dependence on external lenders.

Therefore, central government should take a number of measures, including:

- establish international cooperation with international financial and credit institutions, and other governments to promote positive flow of foreign investments and to increase budget revenues;
- implement structural reforms in the sector of general government management to improve efficiency of using budget funds, transition from passive funds attraction for budget deficit to system of debt management;

Tab. 2: Factors of impact on public debt status

Factors of impact on public debt status	
Factors of direct impact	Shortcomings of the regulatory framework of governing public debt and use of borrowed funds.
	Inefficient use of borrowed funds, lack of strict control over the targeted spending of international credits, and lack of appropriate government supervisory bodies.
	Growth of the government budget deficit.
	Significant amount of previous debts by loans that are provided by international organizations.
	Sharp fluctuations in the official exchange rate.
	Increase in inflationary processes and national currency devaluation.
Factors of indirect impact	Protracted political crisis and military conflict, which require additional defence spending.
	Availability of state's social and other obligations, which must be carried out, despite economic instability (population access to affordable energy resources, pensions, etc.)
	Need for additional funds to implement structural reforms and stabilize the economic situation.

Source: Elaborated by the authors

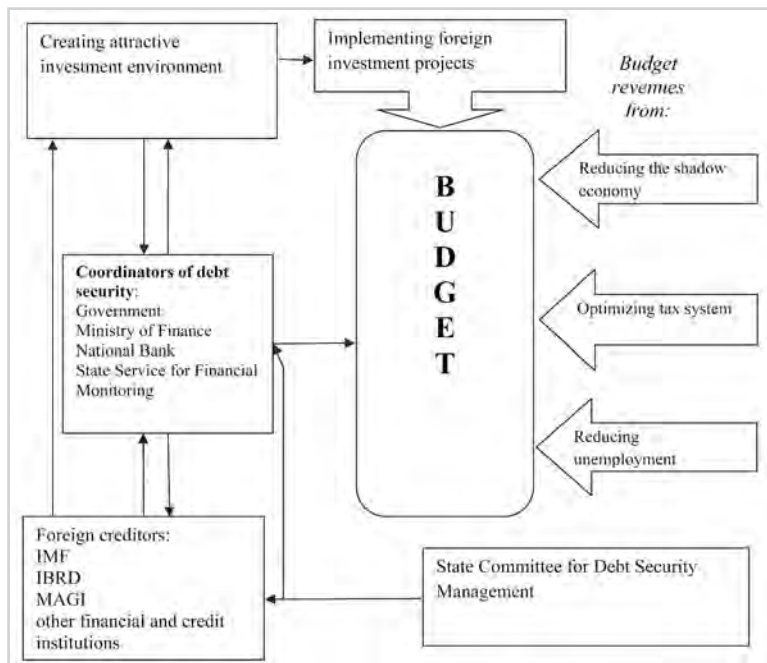


Fig. 3: System approach to public debt management  
Source: Elaborated by the authors

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