DEFINITIONS

Public debt refers to loan raised by a government within the country or a form of promise outside the country.

Philip E. Taylor- the debt is in form of promose by treasury to pay the holders of these promises a principal sum anain most instances interest on that principal

Findlay Shirras- National debt is a debt which the state owes to its subjects or nationals of other countries

OBJECTIVES/ CAUSES

- To cover budgetary deficit
- Unpopularity of taxation
- To maintain economic stability
- To maintain economic development
- To meet unexpected contingencies
- To finance wars
- To finance public sector enterprises
- For welfare Programmes
- To create social overheads
- For better resource allocation
- Create essential non income yielding assets

CLASSIFICATION OF PUBLIC DEBT

- Internal and External
- Productive and Unproductive
- Voluntary and Compulsory
- Redeemable and Irredeemable
- Short, Medium and Long Term
- Funded and Unfunded
- Marketable and Non Marketable
- Gross and Net

Internal/ External Debt

- **Internal Loans** are raised from individuals, NBFIs, Commercial banks and Central bank within the area controlled by public authority.

Involves only transfer of funds from people to Government with the country.

Productive capacity is not affected

- **External Loans** are raised from individuals or institutions outside the area controlled by public authority.

Net payments go out of the country as interest payments.

Productive capacity is adversely affected since interest payments are made

Productive/Unproductive Debt

- **Productive Debts** are loans used for projects which yield income to government. Eg construction of steel plants, power projects. These debts are fully covered by assets.
- **Unproductive Debts** are loans used for projects which do not yield income to government. Eg financing war, flood relief. They are called **dead weight debts** as they do not create any assets

Voluntary/ Compulsory Debt

- In case of Voluntary Debts people contribute to Govenments loan programme without any compulsion.
- Compulsory debt implies government use force or pressure for making people subscribe government loans
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Redeemable/ Irredeemable Debt

Redeemable debt are those for which the government is committed to repay at an appointed date.

Loans for which no commitment is made are irredeemable debt.

Short/Medium/ Long Term loans

Short term loans is usually incurred for period from 3 months to one year. Generally for covering temporary deficits in budgets.

Medium term loans are those which are obtained for more than a year and less than 10 years. Eg- For war finance, meet expenditure on education etc

Long Term loans is repayable after long period, generally for a period of 10 years and above. Generally for development finance

Funded/ Unfunded Debts

Funded debt is a long term debt usually for creation of permanent asset. Provision is made for repayment of loan

Unfunded debt is a short term debt for meeting the current needs and paid off within a year.

Marketable and Non Marketable Debts

In case of marketable loan, the securities are traded or negotiable in the open market.

If the bonds are tradable in the stock market, it is non negotiable or non marketable loan.

Gross/ Net Debt

Gross Debt refers to total amount of debt outstanding at any time.
Net debt refers to gross debt minus funds earmarked for repayment.

Mrs Hicks Classification

Dead weight debts- this do not increase the productive powers of the country

Passive debt – does not yield money income and does not increase productive powers

Active debts- creation of assets which do not increase productive power of the community

REDEMPTION OF PUBLIC DEBT

Govt borrows with a promise to repay the Principal and interest. Growing public debt means increasing burden and greater taxation in future which has demoralising effect. If govt fails to meet the previous obligations they will not be able to raise new loans in the future. **Redemption of Public Debt means repayment of debt**

Repudiation

- Government refuses to repay the debt.
- Government does not recognise its obligation to repay the loan- the principal and interest
- Unilateral decision of the borrower.

Methods

- Partial Repudiation- govt. either repays the interest or part of Principal only
- repudiation by means of inflation of currency

Cancellation

- The debt is not repaid . Agreed upon by lender and borrower for non repayment.
- Bilateral decision

Refunding

- Its a process of replacing maturing bonds by issue of nnew bonds.
- Usually done to meet the maturity requirements
- Short term loans are replaced by long term loans.
- Process of postponing debt repayment

Conversion

- Changing old loan into a new one
- Loan is not repaid but form of debt is changed.
- Conversion is the arrangement of interest rates

Sinking Fund

- Most systematic method of debt redemption
- The govt sets apart a certain sum of money every year , the balances are also invested and interest accruing to them are also credited.

Two types

Certain Sinking Fund- Govt. Sets apart a fixed sum of money every year to clear off the debts.

Uncertain sinking Fund- Govt deposits varying amount of money into the fund depending on the budget surplus

- **Terminal Annuities**

  - Refers to the arrangements to settle a part of public debt every year.
  - The debt is redeemed in equal instalments for Principal and interest. These yearly payments are annuities

Two methods

- Serial bond redemption-The debt will be redeemed in instalments in serial number order
- Lottery Method- The debts will be cleared on basis of lots on behalf of shareholders

- **Capital Levy**
  - Heavy tax on property and certain assets exclusively for repayment of debt
  - One time tax , it is not levied again and again
  - Capital assets below a certain value are not taxed
  - Favoured by Ricardo and Pigou to repay heavy debts . Eg war debts

• Redemption of External Debts

- Possible only through earning foreign exchange, done by creating export surplus (unrequired exports)
- If foreign funds are invested in those areas of export producing goods loans may be easily repaid
- If loans are utilised for unproductive purpose, export surplus may increase cost of home consumption and increase burden of public debt


Thank you