

# PUBLIC DEBT

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# PUBLIC DEBT

- Among the non-tax sources, the major source of revenue of the government is public debt. That is, borrowing. It may either be internal or external debts.
- When the government raises revenue by borrowing from within the country, it is called internal debt.
- Similarly, if the government is borrowing from the rest of the world, it is a case of external debt.

# Objectives of public debt

- 1) To bridge the budget deficit (Deficit Financing)
- 2) To fight against depression.
- 3) To check inflation.
- 4) To finance economic development.
- 5) To meet unforeseen emergencies
- 6) An alternate source of income when taxable capacity is reached.
- 7) To finance wars.

# Cont.

8) To finance public enterprises

9) To carry out welfare programmes.

10) To create infrastructure.

11) For creation of productive assets.

12) For creation of essential non-income yielding assets  
(provision of public goods)

# Classification of Public Debt

## VOLUNTARY AND COMPULSORY DEBT

1. **Voluntary debt** is the debt which is not paid by any legal enforcement. Whereas compulsory debt is legally forced in nature. Here people have no option but repay the debt.

## FUNDED AND UNFUNDED DEBT

2. **Funded debt** is long term or 'definite period' debt. A proper agreement and terms and conditions of repayment with the percentage of interest payable are declared. They are used for creation of permanent assets.

- **Unfunded debt** is for a short term and for indefinite period. It is paid through the income received from other sources. These are used for meeting current needs.
- **INTERNAL AND EXTERNAL DEBT**

When the government raises revenue by borrowing from within the country, it is called internal debt. Whereas if the government is borrowing from the rest of the world, it is a case of external debt.

- **PRODUCTIVE AND UNPRODUCTIVE DEBT**

Loans on Projects yielding income (Construction of plants, railways, power schemes etc.) are called productive debt. Loans on non income yielding projects are called unproductive loans (war, famine relief etc.)

## REDEEMABLE AND IRREDEEMABLE DEBT

**Redeemable debts** refers to the loan which the government promises to pay off at some future date. Irredeemable debts are those, principal amount of which are never returned by the government but pays interest regularly.

## SHORT / MEDIUM/ LONG TERM LOANS:

Short term loans are usually incurred for a period varying from three months to one year. Usually governments get such loans from the central bank by using treasury bills. These loans are called 'ways and means advances.'

- Medium Term loans are those which are obtain for more than one year but less than ten years.
- Long term loans are those which are obtain for more than ten years. These are used to finance developmental activities



# REDEMPTION OF PUBLIC DEBT

- Redemption of public debt means repayment of a loan and it is an important responsibility of the government. All government loans should be repaid.

# METHODS OF REPAYMENT OF DEBT

Repudiation: It means refusal to pay a debt by governments. This method was followed by the USA after the civil war and by the USSR after the 1917 Revolution. This method is undesirable and has not been used recently anywhere in the world. Repudiation shakes the confidence of the people in public debt and many provoke retaliation from creditor countries.

- Refunding: Refunding is the process of replacing maturing securities with new securities. In some cases the bonds may be redeemed before the maturing date when the government intends to rearrange the maturity of outstanding debts or when current rate of interest is low. The drawback of this method is that government is tempted to postpone its obligation of debt redemption. This leads to a continuous increase in the burden of public debt in future.

- Conversion of Loans: It is a special type of refunding. Conversion of existing securities into new securities before maturity. It is generally resorted to reduce the burden of debt by converting high interest loans into low interest loans.

- The prescribed form has four different columns:
- a) Actuals of the previous year.
- b) Sanctioned estimates for the current year.
- c) The revised estimates for the current year and
- d) The budget estimates for the next year