PUBLIC FINANCE – I

(PUBLIC DEBT)

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Public Debt Meaning

Public debt refers to borrowing by a government from within the country or from abroad, from private individuals or association of individuals or from banking and NBFIs (Non-Bank Financial Institution (**NBFI**)).

Classification of Public Debt

(a) Internal and External

(b) Productive and Unproductive:

(c) Short-term and Long-term

Causes of Increase in Public Debt

1. War or war-preparedness, including nuclear programmes
2. To cover the budget deficits on current account
3. To undertake public welfare schemes
4. Urge for economic growth
5. Inefficiencies of public organisations and corruption

Methods of Debt Redemption

Utilisation of surplus revenue: This is an old method and badly out of tune with the modern conditions. Budget surplus is not a common phenomenon. Even when there is a surplus, it cannot be used for making any substantial reduction in the public debt.

Purchase of government bonds: The government may buy her own stocks in the market, thus wiping off its obligation to that extent. This may be done by the application of surplus revenues or by borrowing at low rates, if the conditions are favourable.

Terminable annuities: When it is intended completely to wipe off a permanent debt, it may be arranged to pay the creditors a certain fixed amount for a number of years. These annual payments are called ‘annuities’. It will appear that, during the time these annuities are being paid, there will be much greater strain on the government finances than when only interest has to be paid.

Conversion of high-interest-rated loans to low-interest-rated loans: A government may have borrowed when the rate of interest was high. Now, if the rate of interest falls, it can convert a high-rated loan into a low-rated one.

Sinking fund: This is the most important method. A fund is created for the repayment of every loan by setting aside a certain amount every year out of the current revenue. The sum to be set aside is so calculated that over a certain period, the total sum accumulated, together with the interest thereon, is enough to pay off the loan.

Burden of Public Debt

If the debt is taken for productive purposes, for e.g., for irrigation, transportation, railway, roads, information technology, human skill development, etc., it will not mean any burden. Infact, they will confer a benefit. But if the debt is unproductive it will impose both money burden and real burden on the economy.

(a) Burden of internal debt: Internal debt involves a series of transfers of wealth within the country, i.e., from lender to government and then later on at the time of redemption from government to lender. Money is thus transferred from one section of the community to other sections. In this case the money burden on the economy is zero.

(b) Burden of external debt: External debt also involves a series of transfer of wealth from the foreign lender to the borrowing country, and when it is repaid the transfer is in the opposite direction. As the borrowing country paid interest to the foreign lenders, a direct money burden is fall on the whole community.

Effects of Public Debt on Production, Consumption, Distribution and Level of Income and Employment

Effects on Production: Public debts are raised to finance productive enterprises of various kinds, e.g., steel works, cement, multipurpose projects, construction of ships, railway lines and highways, heavy electrical and engineering works, mining, oil refining, etc.

Effects on Consumption: When people subscribe to government loans, they generally have to curtail consumption. Since investment of funds raised by borrowing raises the level of employment and as a result raises the level of consumption.

Effects on Distribution: Public loans transfer money from rich to government. The fiscal operations of the government are to benefit the poor primarily. The incomes of the poor increase directly through increased employment or it benefits them in directly through the enlargement of social services.

Effects on the Level of Income and Employment: In modern times, public borrowing is resorted to in order to raise funds for financing agriculture, industry, mining, transportation, communication, etc. It increases employment opportunities, the level of income and standard of living.