PUBLIC DEBT

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Meaning

Public debt refers to the loans raised by govt. It is one of the means to finance govt. expenditure. When govt. expenditure exceeds its receipts, it borrows from its own citizens as well as from foreign countries.

Public debt is generally in the form of bonds or treasury bills.

Definitions

- P.E. Taylor: Public debt is in the form of promises, by the Treasury to pay to the holders of these promises a principal sum and in most instances, interest on that principal.
- Findlay Shirras: Public Debt is a debt which a state owes to its subjects or to the nationals of other countries.

Sources

I) **Internal:** exists within the political boundaries of a country

1. **General Public:** in the form of bonds, debentures, etc.
2. **Commercial Banks:** by subscribing to govt. bonds and loans.
3. **Non Banking Financial Institutions:** insurance companies, investment trusts, mutual funds etc.
4. **Central Bank:** purchases govt. securities and credits money

II) External Sources: outside the political boundaries of a country.

1. **International Financial Institution:** IBRD, IMF, IDA, IFC, ADB etc.
2. **Foreign Governments:** advance countries
3. **External Commercial Borrowings:** international financial markets. - London Money Market, New York Money Market, Hong Kong Money Market Etc.

Types

1. Productive and Unproductive Debt

Productive - for productive purposes

-increases revenue and the productive capacity

-not difficult to repay

Unproductive- not spent on productive purposes

- will not add to the productive capacity
- difficult to repay.
- ‘dead weight debt’
- on war or to face natural calamities.

2. Voluntary and Compulsory Debt

Voluntary- according to ability, will and convenience

Compulsory- compelled to subscribe the bonds

3. Funded and Unfunded Debt

Funded- govt. establishes a separate fund

- long term debt

- for creating permanent assets.

Unfunded- no separate fund

-short term loans.

-floating debt.

4. Internal Debt and external Debt

Internal- within the country.

External- from outside the country

- foreign govt., private foreign institutions, international institutions.

5. Redeemable and Irredeemable Debt

Redeemable- govt. promises to repay in some future date

- terminable loans

- on the expiry of maturity period govt. pays the principle amount

Irredeemable- no promise is regarding exact date of maturity

- pays only interest and principal amount is never returned

- creditor can realize cash only by selling them to others.

6. Short, Medium and Long Term Debt

Short term- a period of three to nine months

-Treasury bills are used, low interest

Medium term- within two to three years

-intermediate rate of interest.

Long Term- a decade or even more.

-Used to finance developmental projects.

7. Callable and Non-Callable debt

Callable- repaid before their maturity.

Non-callable- cannot be repaid before maturity

8. Marketable and Non-marketable

Marketable- govt. securities bought and sold in open market..

Non marketable- can not be bought and sold in open market

9. Gross and Net Public debt

Gross public debt- total amount of debt outstanding at any time.

Net public debt- gross debt minus sinking funds

Debt Redemption

It means repayment of public debt by the govt. It is a way of escape from the burden debt. It also ensures the credit worthiness and enhances trust of public.

Methods of Debt Redemption

1.) Refunding- issue of new securities to repay the matured loans.

- Short term securities are replaced by long term securities.
- Money burden of debt is postponed.

2.) Conversions- changing of an existing loan into a new loan

- High interest debt converted to low interest debt.

- at the time of repayment or before maturity

- substitution of a new debt and a voluntary process

3.) Surplus budget- spending less than revenue obtained

- surplus utilized to repay

- to purchase its own bonds and creates automatic liquidation

- rare phenomenon

4.) Sinking Fund- separate fund created

- credits every year a fixed amount of money

- sufficient enough to pay off the funded debt

5.) Terminable annuities- reducing debt burden in stages by installments.

- issues terminal annuities to bond holders, a portion of it matures every year.

- burden diminishes every year

- by the time of maturity it is fully paid

6.) Additional Taxation- new taxes imposed to get sufficient revenue to repay

- transfer of resources

7.) Capital Levy- ‘once for all’ tax to redeem a public debt

- on capital assets on a progressive scale

- after war or emergency

8.) Surplus balance of payment- accumulation of foreign exchange reserves

- increasing exports and curbing imports

- foreign debts for productive purposes

9.) Compulsory Reduction of Rate of Interest

- during financial difficulties interest rates reduced by compulsion

- Creditors have no option except to accept

10.) **Repudiation-** extreme method

- Refusal to repay- not paying off a loan but destroying it
- Done completely or partially
- leads to loss of confidence of public in govt.
- Employed only in extreme circumstances