

Public Debt

Public Debt

- Public debt is the total amount, including total liabilities, borrowed by the government to meet its development budget.
- In India, public debt refers to a part of the total borrowings by the Union Government which includes such items as market loans, special bearer bonds, treasury bills and special loans and securities issued by the Reserve Bank. It also includes the outstanding external debt.

- **Classical views on Public Debt:** In the Nineteenth Century and the early part of the Twentieth Century public debt was condemned by early classical economists mainly because of their lack of faith in the role of state in economic activities. David Hume, Adam Smith and David Ricardo had identical views about the consequences of public debt.

- **Keynesian Approach to Public Debt:** The modern theory of public debt is an offset of the economics of depression or the Keynesian economics. The economic anomaly created by the Great Depression of the 1930s gave way to the development of the new theory of public debt.
- But S E Harris observes that once the economists allowed for unemployment, assumed elasticity in monetary supplies and agreed that that Government expenditures could be productive and need not necessarily be wasteful, the case of public borrowing was strengthened. “Prof. AH Hansen the exponent of modern fiscal theory said that public debt is an essential means of increasing employment and has become an instrument of economic policy today.

Classification of Public Debt

- **1. Internal and External Debt:**
- Public loans floated within the country are called internal debt. Public borrowings from other countries are referred as external debt. External debt represents a claim of foreigners against the real income (GNP) of the country, when it borrows from other countries and has to repay at the time of maturity.
- External public debt permits import of real resources. It enables the country to consume more than it produces.
- **The following points of distinction between internal and external debts are noteworthy:**
- a. An internal loan may be voluntary or compulsory, but an external loan is normally voluntary in nature. Only in the case of a colony, an external loan can be raised by compulsion.

- b. An internal loan is controllable and can be estimated beforehand with certainty, while external loans are always uncertain and cannot be estimated so confidently. Its realisation is very much conditioned by international politics and foreign policies of the lending government.
- c. Internal loan is in terms of the domestic currency, while external loans are in terms of foreign currencies.

- **2. Productive and Unproductive Debt:**

- Public debt is said to be productive or reproductive, when government loans are invested in productive assets or enterprises such as railways, irrigation, multipurpose projects etc., which yield a sufficient income to the public authority to pay out annual interest on the debt as well as help in repaying the principal in the long run.
- As such, a productive public debt is self-liquidating in nature; so the community experiences no net burden of such debt.
- An unproductive debt, on the other hand, is one which does not add to the productive assets of a country. When the government borrows for unproductive purposes like financing a war, or for lavish expenditure on public administration, etc., such public loans are regarded as unproductive.
- Unproductive loans do not add to the productive capacity of the economy, so they are not self-liquidating. Unproductive public loans thus cast a net burden on the community, as for their servicing and repayment purpose, government will have to resort to additional taxation.

- **3. Compulsory and Voluntary Debt:**

- When government borrows from people by using coercive methods, loans so raised are referred to as compulsory public debt. Under the Compulsory Deposit Scheme in India, tax-payers have to compulsorily deposit a prescribed amount and defaulters are punished. This is a case of compulsory debt.
- Usually, public borrowings are voluntary in nature. When the government floats a loan by issuing securities, members of the public and institutions like commercial banks may subscribe to them.

- **4. Redeemable and Irredeemable Debts:**

- On the criterion of maturity, public debts may be classified as redeemable or irredeemable. Loans which the government promises to pay off at some future date are called redeemable debts. For redeemable debts, the government has to make some arrangement for their repayment. They are, therefore, terminable loans.
- Whereas loans for which no promise is made by the government regarding the exact date of maturity, and all that the government does is to agree to pay interest regularly for the bonds issued, are called irredeemable debts.
- Their maturity period is not fixed. They are generally of a long duration. Under such loans, society is burdened with a perpetual debt, as tax-payers would have to pay heavily in the end. Therefore, redeemable debts are preferred on grounds of sound finance and convenience.

- **5. Short-term, Medium-term and Long-term loans:**
- According to their duration, redeemable loans may further be classified as short-term, medium-term or long-term debts. Short-term debts mature within a short period say, of 3 to 9 months. For instance, Treasury Bills are an instrument of credit extensively used as a means of short-term (usually 90 days) borrowing by the government, generally, for covering temporary deficits in the budgets. Interest rates on such loans are generally low.
- Long-term debts, on the other hand, are those repayable after a long period of time, generally, ten years or more. For development finance, such loans are usually raised by the government. Long-term loans usually bear a high rate of interest.
- Similarly, loans of medium-term (in between short-term and long-term) are floated by the government, bearing intermediate interest rates. For war finance, or to meet expenditure on education, health, relief work, etc., such loans are generally preferred.

- **6. Funded and Unfunded Debt:**

- Funded debt is, in fact, a long-term debt, exceeding the duration of at least a year. It comprises securities which are marketable on the stock exchange. Funded debt in its proper sense is, however, an obligation to pay a fixed sum of interest, subject to the option of the government to repay the principal. In such debts, the creditor bond-holder has no right to anything but the interest.
- Unfunded debts, on the other hand, are for a comparatively short duration. They are generally redeemable within a year. Unfunded debts are, thus, incurred always in anticipation of public revenue, a temporary measure to meet current needs.

Burden of Internal Debt

- Increases inequality: Govt securities bought by rich, loan repaid through tax collected from poor.
- Affects ability to work, save and invest: Impact of taxation
- Transfer of purchasing power from younger to older generations: Bonds held by the older generations, taxes paid by younger generations
- Burden of war financing: After war, prices fall, money value rises and real burden of debt rises
- Burden of deadweight or unproductive loans
- Reduction in private investment

Burden of External Debt

- Money burden
- Real burden: Loss of welfare due to taxation
- Effect on production and allocation of resources
- Unproductive foreign debt
- Foreign currency burden
- Domination of creditor country

Public Debt and Fiscal Solvency

- Fiscal Solvency: Financial solvency is defined as the ability of the government to pay their debts and have ability to pay for future needs.
- Governments are expected to ensure fiscal solvency by keeping public debt within limits. This is called as fiscal sustainability.
- Fiscal Sustainability can be measured with:
 - Public debt to GDP Ratio: High ratio-low economic development-low foreign investment
 - Public Debt to export ratio

Public debt to GDP Ratio (2020)

<u>Russia</u>	17.8
<u>Australia</u>	24.8
<u>China</u>	66.8
<u>India</u>	73.95
<u>United States</u>	128
<u>Japan</u>	266

Debt Management Framework by IMF and WTO

1. Debt management objectives and co-ordination between all the decision-makers
2. Transparency and accountability: Clearly defined objectives, publicly disclosed risks, costs etc., information of the past, current and future fiscal activities of the govt
3. Institutional Framework: legal framework to decide the authority to borrow, issue new debt, invest and undertake new transactions for the govt.
4. Debt strategy with min. risk
5. Efficient market for govt securities

