Notes on

Public Debt / Borrowing

Introduction

Public debt is a source of collecting income by state. Public or local debt is the debt the state collects from the citizens of other countries. When government borrow, then it gives birth to public debt. Government can take debt from banks, business or organizations, business houses and the person. Government can take debt from inside the country and from outside the country, or from both the sides.
According to **Dalton**, **"Public debt is a way of collecting income from public officers".**

According to **Prof. J.K. Mehta**, **"Public debt is comparatively modern incident and it would come in practical form with the development of democratic governments".**

According to **Adam Smith, "Public debts create the conditions of war and extra expenditure".**

Causes of Borrowing / Public Debt

Government can borrow because it can possible that local income was not enough for their expenditure due to incidental expenditure government could have to borrow because it is not possible to increase the tax income at that point. Government can borrow finance arrangement of capital expenditure because current revenue will not be enough to fulfil the target.
At the time of depression, when private demand is not enough then government borrow, the extra savings of people which is not in use and spends it to increase the effective demand and by this gives birth to the extra income and employment in the society. These extra amounts from government taxes are supplementary to each other.

1. Small Share of Taxes in National Income: After India got independence, there is an increase in national income four times more. In present, there is a part of tax less than 20% in the national income but this percentage in America is 22.42%, in Sweden 26.3%, in Australia 27.9%, in Nederland 29.2% and in England 30.4%. Except this, in these countries, the most part of income from taxes got from direct taxes and in India the most part of the tax income is from indirect taxes. So, in this condition, fiscal policy cannot be able to help in the increase in the development of Economy.

2. Burden of Indirect Taxes: In Indian tax system, there is a burden of indirect taxes that is not just. In the economy there is an inflation increase in indirect taxes that the complete tax arrangement has become imbalance and unjust. Most of the pressure of taxes are from in indirect taxes the lower class people who have to face as comparison to rich section so this increase, economical problems in society. Regarding this, **Prof. K.T. Shah** says right, "Even there is more tax ability in rich section and there is less tax pressure on them. In its opposite, on lower section the tax pressure is equal to the part of lion and the ability to face is equal to the baby sheep".

3. Imperfect Tax System: The Indian tax system is not work perfect. In India, there is very high tax evasion because our tax system is full of error. According to the idea of **Prof. Kaldor,**

in India there are tax evasion of ` 200/- to ` 300/- crore, every year. Except this, the complete part of income tax is never collected.

4. Misuse of Public Income: In India, a big part of public income misuses. A big part is spent on undeveloped plans, except this some plans are started on the basis of standard. A big quantity is spent on them even public got no gain from these. There is a big quantity spent on government departments where there is corruption, bribe, and red tapism available and work is completed with very difficult. By this reason, there is a reduction in production.

5. Increasing Public Debt: To fulfil the five year plans in India, there is a big quantity of financial resources needed. To fulfil this public debt is to be taken as a help. And there is a regular increase in the pressure of it. Because of most of them depend on foreign debt, there is non-definite plans of economic development.

Objectives of Public Debt / Borrowing

1.Income and Revenue: The target of public debt normally is to cover the ditch that developed in any year between proposed expenditure and expected revenue. Whenever because of increased administrative expenditure or flood, feminine, earth quake and communicable diseases like unexpected problem government's income becomes less because they have to spend it to covers these problems then government cover it by taking Indian and Foreign debts. This is the government; whose income is different from all the taxes and revenue sources.

2. In Times of Depression: Depression is the condition when costs reduce, there is a lack of courage in people for spending money on industries and in future there is no possibility of getting gain. This condition can be removed when there is increase in the demand of things and services and that is possible when in the country there is an increase in the expenditure of public construction work or most important public use and infra-structure services.

3. To Curb Inflation: Inflation is the name of that condition at the time of increased cost. So, government by taking debt can take back a big quantity of work power from the hands of people but modern economists believe that as comparison to government tax, taxation is said to be more important will to remove inflation, because if the debted government money is never used in productive use, it increase the responsibility for government to give it back. But waste tax - income can easily to be debited in the government fund so the pressure can be removed from production in economy.

4. To Finance Development Plans: In undeveloped economy, there is always a lack. In these countries, as the ability to pay the bill is less. So, government cannot take shelter on heavy taxation. But to remove poverty from the country, this is also most needed and important to do arrangements of development plans. In this condition, the only way is to take public debt. So, the governments of undeveloped countries take debts from within the country or from foreign governments or from people to do finance arrangements.

5. The Finance Public Enterprises: Government also takes debts for the arrangement of finance for the commercial enterprises running by itself.

6. Expansion of Education and Health Services: Government can also take debt for the construction and development of education and health services and other services like this.

That helps to increase normal social welfare but does not give any direct finance and that is not productive from the angle of currency.

7. To Finance War: Government can take debt for the self-defence work. In the present century of increased international pressure and atomic war, there is a need of money in big amount to save the country from foreign attacks and for self-defence services and to do the arrangement of modern decoration. But it is very difficult to collect the money for modern wars only by taxation because it affects the production unfavourably. So, to cope up with this type of situation government can take shelter from public debt from inside and outside the country.

8. For the Establishment of Social Society: For the establishment of socialist society, government is doing nationalism of industry and business in present time and running it themselves, but to run modern industries, there is a need of big quantity of money government can only fulfil this by taking debts.

9. To Cover the Expenditure on Administrative Work till Getting Income: The income which government got from taxes that is available at the end of the year but expenditure is from the starting of the year so at the beginning of the year government spends money by taking debt and pays the debts when it got the income in the last of the year.

10. To Make the Public Verdict Favourable: When the citizens are not able to pay the tax then the government have to take debt. Sometimes even then the more capability of public, the government never increase taxes because the public verdict sticks to favourable.

Classification of Public Debt

Economists have divided debt on the bases of use, target, time limit and terms of payment. The different types of public debt are following –

1.Internal and External Debt

Internal Debt: - Internal debts are those public debts taken from the country inside, but the external debt is a debt taken from foreign governments. Foreign people and international organizations, In **Dalton's** words, "A debt is internal if given by those people or organizations living in that area that is controlled by the local officer of taking debt.

External Debt: - A debt is external, if given by those people and organization living outside of that area". By the payment of interest on foreign debt, there is a reduction in net income of debtor country because their income's big part goes to the foreign country, but it doesn't effect at the time of paying interest on internal debts. Whether the interest on internal debts leave on tax payers or taken from them and paid as a form of interest on war debts, it does not affect the national income of the country, that becomes stable like before. This is form of method by which money is taken from the taxpayer one pocket is been debt in another pocket.

2. Productive and Unproductive Debt

This classification depends upon on the use of public debt. Debts can be used for the production works and unproductive debt.
Productive debt: - Productive debts are those debts which are used in those plans which provide income, like railway, plans of electricity and the plans of irrigation. The income got

from these plans can be used to the payment of yearly interest and for the payment of Principle. So, productive or reproductive debts are those debts where are same costs or the assets of more cost kept. By this, productive debt never put pressure on government and taxpayer.

Unproductive debt: - unproductive debts are those debts used in that plans, no income is provided, for example, war. So, unproductive debts are those debts, no assets is in the back. The main reason of unproductive debt is not only on war but at some point the losses of interest is also the reason.

3. Redeemable and Irredeemable Debt

Redeemable debt: - Redeemable debts are those debts the government promises that he will pay back the debt on a fixed date. These debts are also called **terminable debt.**

Irredeemable Debt :-Irredeemable Debts are those debts which are without any promise they are called **irredeemable** or **perpetual** debt. When debts are not returned then the governments have to do same arrangement to paid back the debt. If government decides that these debts will be paid back from the tax income, which is the best way in almost all the situations for this work they have to put new taxes. So in the condition of redeemable debts government have to pay both interest and principle amount on a fixed future coming date.

4. Funded and Non-Funded Debt

Government debt can also be divided in the form of funded and non-funded debt.

Funded debts: - Funded debts are long term debts. Payment of these debts can be done within one year or it can be possible, not to give any promise regarding this in other words funded debts are those debts, in which the payments are given with in, one year.

Unfunded debts: - Treasury bonds are unfunded debts, because these debts are given for three or six months and their time period is not more than one year. Even then, this is clear that in the condition of funded debts, government is responsible to pay the regular payment of interest to the debt payer; yes, their basic money payment is totally left on the government.

5. Voluntary and Compulsory Loans

Voluntary debt: - Government debts are normally of voluntary nature and to person and organizations controlled by the government bonds are voluntary.

Compulsory Loans: - Today compulsory loans are not much popular but in the condition of war, government are can put pressure on people to give loans. Government can also help in the condition of depression, so that work power from the hands of people could be reduced and stop the increasing rates.

6. With Rate of Interest and without Rate of Interest

Debt with Rate of Interest: - On loans **with rate of interest**, government gives interest on a fixed rate to the loan taker after a fixed time period.

Debt without Rate of Interest: - debt **without rate of interest**, loans government don't have to pay any interest.

7. Purchasable and Non–Purchasable Debt

Purchasable debts: - it includes government securities; whose sale and purchase is not possible independently.

non-purchasable debts: - In opposite, those securities are included in non-purchasable debts, whose sale and purchase is not possible in the open market and can only give back to the government on a fixed rate.

8. Total Debt and Net Debt
Total Debt: - On a fixed time, whatever debts governments have, the total of all is called total debt.
Net Debt: - If government collects any fund to pay back the debts, then the amount of that fund subtracted from the total debt and whatever left is called net debt.

9. Short Term and Long Term Debt
Short Term Debt: -When government takes debt for a short period, then this is called short term debt. These debts are paid back in the time period with in a year that is to be taken to complete the tenure of debts.
Long Term Debt: - When governments take debt for a very long period then this is called long term debit. The time of giving it back is not fixed. At that time the debt is paid back, the debt giver got regular interest.

Advantages and Disadvantages of the Public Debt

Advantage of Public Debt
Advantage of public debts are as follow:
1. Increase in Origin in Money: - Public debts encourage industries in country, production increases, national income increases by which the life standard of citizens of the country increases.
2. Suitable Repayment Balance: - Business and repayment balance become in favour of taking debt and the problem of foreign investment solves.
3. Economic Development: - Undeveloped countries become capable to do their economic development by public debts.
4. Control on Natural Calamities:- Government takes the help of public debts to control natural calamities.
5. Successful War Conduction: - Wars have become very expensive today. Therefore, taking debt is essential for conduction of war.
6. Harmony: - Equal and suitable distribution debts take place by which harmony and cooperation increase.
7. Secure Investment: - Public debts are secure sources of investment and every individual considers it profitable to invest money in it.
8. Public Works: - With the help of public debts public works and plans like building of roads, water-electricity, canals, bridges etc. can be implemented by government.
9. Non-economic Benefits: - Friendly relations develop between countries taking and giving debts from public debts.

Disadvantages of Public Debt
1. Misuse of Resources of Country: - Such conditions must be laid while taking public debts that the industries on which debt is used, that must have partial control on country debtor. Misuse of sources of country takes place in favour and a big part of money goes to foreign countries as interest.
2. Fear of Government's Bankruptcy: - If government receives debt easily then there is a fear that whether government may receive such a large amount of debt whose repayment may become impossible.
3. Nature of Extravagancy: - When public debt begins to receive easily then there is a fear of its extravagancy.
4. Political Burden: - Debt-giver country intervenes in the policies of debtor country for the defense of capital of their citizens and debtor country loses its political freedom.

5. Emergency: - There is a fear of emergency like political controversy and war from public debts.
6. Burden on Public: - When debts are taken for non-productive works then the burden of tax is increased on public for its repayment.
7. Economic Backwardness: - Foreign debt makes the economy of the country weak and country begins to depend on other for their economic development.

Redemption of Public Debt
Redemption of debt means – return payment of debt. Excluding permanent investment in self-dependant industries, all public debts must be returned as possible. Regarding control and the regular transfer of debt provision of their payment must be done when they are issued. Government searches opportunities to postpone the payment of their debts. But, it must be done that being confident about the regular payment of debts; each possible caution must be treated.

Advantages of Debt Redemption

1. It avoids bankruptcy of government.
2. It discourages extra useless expenditures of government.
3. It encourages faith of debters in government.
4. To issue debt by the government becomes easy in future.
5. It reduces the cost of debt-management.
6. If debt is paid early then it saves future payment from the burden of tax.
7. When the payment of public debts is done then these sources are transferred towards private investment. In that condition, an environment creates for private investment.
8. Reimbursement may work as the deflationary measure.

Methods of Repayment

Now, we will study the different methods of reimbursement. These methods are as follows:

1. Debt Repudiation
Debt Repudiation means to deny the payment of debt by government. In 1917 it had done by Soviet Govt. Whereas he denied to pay Czarian debts. In this way, in some states of United States of America, before domestic war of 1861-1865, same thing had done who denied to pay debts from English citizens. When government denies to pay debt then the faith of people and banks in government shatters. Because of it, government has to face difficulty in issuing new debentures to government in near future. This step of government is considered very inconsistent and discriminative because this affects only that group who buys debentures debt consistent and it leaves other groups unaffective.

2. Refunding
If government issues new bonds for the payment of its current debts then it is called refunding, Refunding is a name of that process by which new bonds are changed in place of maturing bonds. Sometimes, payment is done before maturing date of bonds. It happens so whenever the rate of interest is low or government wants to change the maturity date of remaining debts. But, the meaning of refunding is considered so that the needs related to maturity of debt can be fulfilled. Generally short-term debts which are spent for the fulfilment of current expenditure which are paid from the money received by sale of long term debts in public latter so that the place of short-term debts can be taken from long-term debts.

3. Conversion of Debts

Conversion of Debts means change of old debts into new debts. According to this theory, the payment of debt is not done in reality, but only the form of debt is changed. The, process of conversion of debts means to change high interest rate debt into low interest rate debt. It is possible that when government has taken debt, at that time the rate of interest is very high. But, now, when the rate of interest is lowered then government changes old debts into new debts so that the burden of taxes on government must be minimum. Then, low interest rate on public debt means low unequal distribution of income.

Actual Repayment

Following methods are adopted for actual payment of public debt. Here, this question arises that the actual payment of debts must be done slowly and slowly or quickly. But, this fact depends on income and capital of the countries taking loan and specially when more debt is taken from foreign countries.

1. Sinking Fund: - The method which is normally adopted for regular repayment of debt is the construction of sinking fund, means the construction of such fund in which a definite part of government income is submitted every year and the payment of debt is done from this fund. This fund is used for the purchase of debts and for the last payment when their duration completes. Earlier, the flow of money in sinking fund was available till that time until the duration of debts completes. But, these days, when the money is available in these funds then it is immediately used for the settlement of debts.

2. Surplus Revenues: - The policy of surplus budget is also adopted for settlement of public debts slowly and slowly each year, instead of this that firstly, one fund is constructed and then their repayment is paid on completion of duration. But, these days, government expenditures are increasing rapidly. Therefore, surplus budgets are rarely therefore, surplus are rarely made. In addition to this if government makes surplus budget in the duration of depression then it will be considered an unintelligent step of government. Therefore, the policy of surplus budget cannot be implemented in the duration of depression in this situation reimbursement of debt cannot be done.

3. Terminal Annuities: - Government can issue such terminal annuities, a part of which matures every year according to a serial number and their payment is paid every year. The determination of serial number is either done in the starting or by lottery. Debt is reduced each year in this system the burden of interest reduces each year in same quantity, in this way, it is a system of returning instalments of debts. The burden of debts reduces every year according to this system and they are settled completely before completing the duration of debts.

4. Capital Levy: - Capital levy is an indicator of very heavy taxes on property and wealth. It is imposed only once on properties of capital of more from a definite value. Capital levy has been instructed to be imposed just after war so that wartime proportional debts can be paid. They are imposed serial wise on single property.

Repayment of External Debt

Sinking of foreign debts can be only when foreign currency is earned for their repayment and foreign currency can be earned only when export surpluses are created in comparison to import. If foreign debts are invested in such trade which increase the completion of substances of export, then foreign debts can be repaid easily. But, if foreign debt is used for unproductive works then export surpluses can only be created when there must be reduction in domestic consumption. In this condition, people fear the burden of foreign debt.