Public Debt

- Meaning of Public Debt
- Types of Public Debt
- Burden of Public Debt
- Management of Public Debt
Public Debt

• Public debt is one of the important source of income to the government in times of financial crisis, emergencies like war, drought, etc.

• The act of borrowing by public authority creates a Public debt or Public borrowing.
Public Debt

• Public debt: Government bonds or securities
• In India: Treasury bills, Post office, saving certificates, National Saving Certificates, etc.
• Public debt: Internal or External.
• Internal debt refers to the public loan floated within country, while external refers to the obligation of a country to foreign governments or foreign nationals, or international institutions.
Role of Public Debt

- Smoothening out the tax rate.
- Macro economic stabilization
- Financing war or other emergency expenditures
- Meeting part of current expenditure
- Remunerative capital formation by the government
- Filing saving and investment gap
Types of Public debt

- Productive and Unproductive debt
- Voluntary and Compulsory debt
- Internal and External debt
- Short term, Medium Term, and Long term debt
- Redeemable and Irredeemable Debt
- Funded and Unfunded debt

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Burden of Public debt

- Public debt constitutes the financial obligation or liabilities of the government.
- Debt burden is measured as ratio of outstanding debt to GNP.
- Debt = Outstanding Debt / GNP.
- Burden of Public Debt consists of the sacrifice that taxpayer have to make for financial repayment of principle and interest.
Burden of Internal debt

- Increases inequality: Purchasing power transfers from poor to rich.
- Adversely affects the ability and desire to work, save and invest
- Transfer purchasing power from young to older generation.
- Burden of unproductive debt: not self liquidating
- Reduces private investment.
Burden of External debt

- Direct money burden: The size of the burden would depend on the rate of interest and amount of the loan incurred.
- Direct Real burden: It is measured in terms of loss of welfare suffered by people of the debtor of the country due to repayment of debt.
- Indirect money burden and Indirect Real burden: This is measured in terms of effect on the production and allocation of resources.
Burden of External Debt

• Burden of unproductive foreign debt: The magnitude depends upon whether the debt is incurred for productive purpose or unproductive purpose. If incurred for unproductive purpose it will create greater burden on the community.

• Foreign currency burden increases
Management of Public Debt

• Strategy for managing the government’s debt in order to:
  ✧ Raise the required amount of funding
  ✧ Achieve its risk and cost objectives
  ✧ To meet any other debt management goals of the government such as developing and maintaining an efficient market for government securities.
Redemption of Public Debt

- Refers to escaping from the burden of public debt.

Various methods of Debt Redemption are as follows:

1. Repudiation: Writing off the loans i.e. not repaying

2. Refunding: Issue of new bonds and securities by the govt. to repay the matured loans
Redemption of Public Debt

3. Conversion: Refers to a process by which public debt with higher interest is converted to a debt of lower interest rate.

4. Capital levy: Refers to a very heavy once for all tax on capital assets, property and wealth.
Redemption of Public Debt

5. Sinking Fund: Accumulating a part of public revenue every year for the repayment of debt. The most systematic and best method for debt redemption.

6. Surplus budget: When Public revenue is more than public expenditure there is a surplus budget. The surplus budget is used to clear off the public debts.
Importance of Public Debt Management

• Helps to reduce the cost of borrowing.
• Helps to develop the domestic financial market
• Facilitates economic development
• Make countries less vulnerable to financial risks.
Framework for Public debt management

• Debt Management objectives: Ensure payments obligation and financial needs are met at lowest possible cost.

• Transparency and Accountability: Objectives of the Debt management should be clearly defined and publicly disclosed.

• Institutional Framework: Legal framework which clarify the authority to borrow and issue new debt.
Framework for Public debt management

• Debt security and Risk Management: Effective debt strategy should be implemented and risk in portfolio should be mitigated.

• Efficient Market for Government Securities: To ensure the policies and operations are consistent with an efficient market for government securities.
1. Greater reliance on domestic borrowing over external debt.
2. Preference for market borrowing over instruments carrying administered interest rate
3. Consolidation of the debt portfolio
4. Development of deep and wide market for government securities to improve liquidity in the secondary market
Management of Public Debt

Institutions responsible for management of public debt

• Reserve Bank of India
• Ministry of Finance, Office of Aid and Accounts Division
• Ministry and Finance, Budget Division and Reserve Bank of India.