benefit, insurance against
ent provides security and
, therefore, reduce his
d save. Hence, the public
egulated in such a way so
affect the willingness to

stribution of Economic
expenditure on the
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es from private to public
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and services. Public
of bounties and subsidies
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es as well as to accelerate
industries.

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particular area, resources
e transferred to that area.
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hat area are used more
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Expenditure on Distri-
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pital accumulation.

Public Debt

Meaning of Public Debt

Public Debt is defined as the total outstanding borrowings of the central government exchequer. It represents the stock of borrowing, as opposed to the annual increase in total borrowing, represented by the government deficit. In a broader sense, all kinds of obligations of a government (including the currency obligations) are included in public debt.

According to Philip E. Taylor, Public Debt is a debt 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.

Public Debt and Private Debt

There are similarities as well as dissimilarities between public debt and private debt.

Similarities—In certain respects government borrowing resemble the private borrowing.

(i) Like a private borrower, the government may also borrow either for consumption or for investment purposes.

(ii) Both have to pay interest on loans that they have taken.

(iii) Private and public borrowings both imply diversion of funds from one use to another.

Dissimilarities—Following are the main differences between public debt and private debt:

(i) A private economic unit can repay its debt either out of its earnings or out of its accumulated assets or by borrowing from the other. On the other hand, the government is the creator of currency and can pay its debt straightway by creating more of it. The fact that it usually does not do so only reflects its concern for the welfare and stability of the economy and not the lack of its power to do so and pay off its debt.

(ii) Excessive debt may lead the individual borrower into a state of insolvency. The same may not be true for the government.

(iii) Public borrowing have a profound effect on various dimensions of the economy-distribution, capital accumulation, economic growth, income and employment stability, and so on. Thus, the government may resort to borrowings as a matter of public policy, even, if it does not need funds. But an individual may not borrow, when he does not need them.

Objectives (Reasons) of Public Debt

Following are the reasons on account of which a government might incur debt :

1. To Cover Budget Deficit—The Gover ment may borrow because its current revenue fa short of its expenditure. Sometimes the gove ment has to borrow to meet large expendi arising because of some unforeseen contingen like floods, famines, epidemics, etc.

2. To Finance War and Natural C mities—There could be wars, or na calamities in which case the government wou committed to a much larger expenditur would therefore run into a debt.

3. To Finance Development Plans government of an underdeveloped country play an active role in the development economy. This may be done through bo and investing those funds in various proje

4. To Finance External Deficit- developed countries need foreign exchan early stages of economic development take high level of investment, purcha equipments and raw materials from abr cover the balance of payments deficits. resources have to be obtained from abr of external debt.

Classifications of Public Del

Public debt can be classified categories. Different classification public debt are as follows:

1. Internal and External P
Internal debt refers to the public within the country, while external the obligations of country to foreig or foreign nationals or internationa

2. Marketable and Non-ma
Debt—If loans can be sold by the to others, they would be called m On the other hand, non-marketab which have been issued in fav debt holders only and cannot be

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2. To Finance War and Natural Calamities—There could be wars, or natural calamities in which case the government would be committed to a much larger expenditure and would therefore run into a debt.

3. To Finance Development Plans—The government of an underdeveloped country should play an active role in the development of the economy. This may be done through borrowing and investing those funds in various projects.

4. To Finance External Deficit—Underdeveloped countries need foreign exchange in the early stages of economic development to undertake high level of investment, purchase capital equipments and raw materials from abroad and to cover the balance of payments deficits. Therefore, resources have to be obtained from abroad by way of external debt.

Classifications of Public Debt

Public debt can be classified into various categories. Different classification or forms of public debt are as follows:

1. Internal and External Public Debt—Internal debt refers to the public loans floated within the country, while external debt refers to the obligations of country to foreign governments, or foreign nationals or international institutions.

2. Marketable and Non-marketable Public Debt—If loans can be sold by the existing holders to others, they would be called marketable loans. On the other hand, non-marketable loans are those which have been issued in favour of particular debt holders only and cannot be sold to others.

3. Productive and Unproductive Public Debt—Productive debt is the debt which is used by the government for directly productive

purposes. For instance, the loan may be used for the construction of railways, irrigation and power projects and for the establishment of heavy industries such as iron and steel, cement and fertilizers. The principal and the interest both can be repaid out of the income derived from these projects. Thus, the productive loans should not be considered as a burden upon the government. On the other hand, unproductive loans are those which are incurred on those projects which do not yield any income. For instance loans taken for financing war and for giving relief in times of flood and drought.

4. Interest-Bearing and Non-interest-Bearing Public Debt—There are two types of interest bearing loans. In the first category, a loan carriers what is called a coupon. The holder of such a loan is entitled to a given interest payment periodically. The second category is where a loan is sold below its redemption value – at a discount. In India treasury bills are sold that way. Some loans, however, do not bear interest at all and are called non-interest bearing loans. There may be, for example, price bonds, certain deposits like earnest money for tenders, and so on.

5. Redeemable and Irredeemable Debts—Redeemable loans are those loans for which the government promises to pay off at some future date. Those loans, for which no such promise is made, are called irredeemable loans.

6. Funded and Un-funded Debts—Funded debt is that public debt for the payment of which the government establishes a separate fund. On the other hand, an unfunded debt is that debt for the repayment of which the government creates no separate fund.

Effects of Public Debt

1. Effects on Consumption—When people purchase government securities, it is not always necessary that they do it out of past savings. Sometimes people buy these securities out of their present income. The small saving schemes in India is of this nature. Hence, the money invested in the National Saving Certificates must, to certain extent, reduce the expenditure of the people in the present. Therefore, in this way the consumption is affected in the same way as it is affected by taxes. But, when the people buy government securities out of their past savings, it does not affect the expenditure of the people at present. And, when people buy government securities out of the
savings, private investment also remains
ted. If, however, it comes from bank deposits
reduces the money with the bank. The banks
therefore, less money to lend to private
Hence, private investment are affected.

2. Public Debt and Savings—In the
borrowing from the market, the net effect
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will depend upon the source out of which
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because the economy's resources will be
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When the government borrow
central bank of the country, the effect is
to restoring to the printing press. By
additional currency, the authorities a
demand forces in the market, causing
pressure on prices.

In an underdeveloped country,
portion of the public debt is likely to be
the commercial banks. The commerc
consider their holdings of government
as a good investment which can be e
any time without much of capital
assured liquidity position, therefore, te
to increase their loans and advances an
to the inflationary pressures in the mark

people buy government securities out of the idle savings, private investment also remains unaffected. If, however, it comes from bank deposits, it reduces the money with the bank. The banks have, therefore, less money to lend to private business. Hence, private investment are affected.

2. Public Debt and Savings—In the case of borrowing from the market, the net effect on savings and capital accumulation in the country will depend upon the source out of which market borrowings come. One possibility could be that the public reduces its own consumption and contributes its savings to the public loans. In this case there will be obviously a net increase in the speed of savings and capital accumulation. Actually most savings are effected only by the richer sections and firms from whom the contributions to public loans should be expected. Here, however, the danger is that the savings which would have gone into investment on private account would be diverted to public loans. If that happens, then there would not be any net increase in the saving and investment activity. But public loans will generate reallocative effects.

3. Public Debt and Inflation—Most governments while raising loans claim that such an activity is not going to add to the inflationary forces. There is only a diversion of demand, but no net addition to it.

Above reasoning is quite misleading because it tries to hide some of the basic facts. Even if public debt only brings about a diversion in demand, it is bound to be inflationary in character because the economy's resources will be diverted from the production of consumption goods into those of capital goods.

When the government borrow from the central bank of the country, the effect is equivalent to restoring to the printing press. By printing additional currency, the authorities add to the demand forces in the market, causing an upward pressure on prices.

In an underdeveloped country, a sizeable portion of the public debt is likely to be owned by the commercial banks. The commercial banks consider their holdings of government securities as a good investment which can be encashed at any time without much of capital loss. This assured liquidity position, therefore, tempts them to increase their loans and advances and thus add to the inflationary pressures in the market.

4. Public Debt and Distribution of Income—The purchasers of government securities are mostly rich people of the community. But the burden of taxes, imposed for finding money for interest payments fall on the poorer classes also. Therefore, the tendency of public debt would be to increase the inequalities of incomes and wealth.

Redemption of Public Debt

Redemption means repayment of a loan. Following are the methods of debt repayment.

1. Repudiation of Debt—One simple way of ending the debt obligations is to repudiate the debt. Repudiation means refusal to pay a debt by the government, as was done by the Soviet Government in 1917. This is, however, totally undesirable. It is usually wrong on the part of the government to do so, and it hits the credit of the government with the result that it will find very difficult to borrow in futures. If an external debt is repudiated it may create a number of grave difficulties for the repudiating country, such as economic blockade, military action, etc.

2. Refunding—If a government sells its bonds to pay its floating obligations, the debt is said to be funded. It is the process by which the government raises new bonds to pay off the maturing bonds. Thus, the government takes a fresh loan to repay an old debt.

3. Conversion—In conversion method, the loan is actually not repaid but the form of debt is changed. The process of conversion consists generally reconverting or altering a public debt from a higher to a lower rate of interest.

4. Actual Repayment—While the first three methods are not concerned with actual repayment of public debt, the following measures may be taken for the repayment of public debt.

(i) *Sinking Fund*—Under sinking fund, the government regularly saves for the retirement of the debt and uses the funds for this purpose when they have accumulated enough. Originally sinking funds are accumulated, until debts are matured, but now they may be used to retire debt as far as funds are available.

(ii) *Terminal Annuities*—Under this method, the government, pays its debt in equal annual installments which include interest as well as the principal amount of debt. The burden of debt is reduced every year.

(iii) *Budgetary Surplus*—A
budget may be followed annuall
public debt gradually instead of c
its repayment.

(iv) *Capital Levy*—Capital
very heavy tax on property an
once-for-all tax imposed on capi
certain value. It is imposed on ri
individuals on a progressive sca
suggested to pay of the war time

Deficit Financing

Deficit financing is used
financing of a deliberately cre
public revenue and public exper

Deficit financing implies th
both on the revenue and capit
match the total expenditure, b
and the capital accounts.

Deficit financing helps
ment in three types of situation

(a) an economy with the fu

(b) an economy with the
and

(c) an economy with sur
surplus capital.

Objectives of Deficit F

(1) The deficit financing
method of meeting the fina
government in the times of
been considered difficult to m

(2) Deficit financing is
the mobilisation of surplus
resources in the economy.

(3) The use of deficit fi
considered essential for fin
economic development.

(4) It is an instrument
for removing the conditions
raise the level of output and

Effects of Deficit Fi

The effects of deficit fi
into two groups, i.e., positi
effects.

1. Positive effects
The positive effects of d
follows :