PUBLIC DEBT

Loans raised by the government within and outside the country

Public debt	Private debt
1.Can Compel/force to lend	1.No compulsion
2. Loans for very long period as govt is permanent	2.Borrow for short period only
3. Borrow from both inside & from outside	3. Domestic borrowing only
4. Loans are taken for productive purpose	4. Both productive and unproductive purposes
5.Purpose-Social welfare	5.Purpose- private profit
6. Can levy taxes for repayment	6. Not possible
7. Low interest	7. High interest
8.High credit worthiness	8.Low creditworthiness
10. Refuse to repay	10. Cannot refuse

OBJECTIVES &IMPORTANCE

1. To fill the gap between revenue & expenditure
2. To fight depression by public investment – confidence problem
3. To curb Inflation –reduce purchasing power with public
4. To finance economic development
5. To meet emergencies- famines, floods, epidemics, earthquakes
6. Unpopularity of taxation- when taxable capacity is reached
7. War finance
8. To correct mal allocation of resources
9. Expansion of education & public services
10. To create infrastructure

SOURCES OF BORROWING

1. **Borrowing from individuals- by issue of bonds-reduce consumption**
2. **Borrowing from Non Banking Financial Institutions – insurance companies, unit trusts etc.**
3. **Borrowing from Commercial banks- own funds, credit creation**
4. **Borrowing from Central Banks- creation of fresh money**

CLASSIFICATION OF PUBLIC DEBT

1.Internal & External
2.Productive & Unproductive
3. Redeemable & Irredeemable
4.Short Term& Long Term
5.Funded Unfunded
6.Voluntary Compulsory
7. Marketable Non Marketable
8. Gross Debt & Net Debt

BURDEN OF PUBLIC DEBT

*Burden of internal Debt
*Burden of External Debt

Burden of Internal Debt

*Direct money burden
*Indirect money burden
*Direct Real burden
*Indirect real Burden

1.Direct Money Burden

Amount of G/S sacrificed due to rise in taxation

Amount of money payment involved in the payment of taxes

At macro level, internal debt involves only a transfer of purchasing power

If tax payers and bond holders same group no direct burden on community

If different, change in distribution

2.Indirect Money burden

1.Loans → Spending on Devt. Projects → Demand for Goods & services → Rise in Prices → *Burden of Inflation.*

2. Taxes for Debt Repayment → Adverse effect on desire to work/save /invest → *Fall in production*

3.Direct Real Burden

1.Tax for Repayment → More tax on poor → Transfer of money to rich bond holders → *Burden on poor*

2. Transfer of Wealth from active to Passive sections of society.

4.Indirect Real burden

Additional taxes for debt repayment- More indirect taxes – Heavy burden on workers- increase income inequality – Reduce incentive to work and save

BURDEN OF EXTERNAL DEBT

1.Direct Money burden
2.Indirect money burden
3.Direct real burden
4.Indirect real burden

1.Direct Money Burden
Loss of G/S by the debtor nation. Debt repaid in Foreign exchange. So that goods are to be exported for earning FE.
2.Indirect money burden
Export-----Scarcity------ price rise------ loss of economic welfare
3.Direct real burden
Taxes for repayment--------Most fall on poor & weaker sections------------Direct real burden
4.Indirect real burden
Taxes for repayment--------adverse effect on ability & willingness to work save ,Invest--------Loss of output
ONLY PRODUCTIVE DEBT

REDEMPTION OF DEBT

- Redemption means repayment of the public debt with interest.

METHODS

1. REPUDIATION
2. CONVERSION
3. UTILISATION OF BUDGETARY SURPLUSES
4. TERMINAL ANNUITIES
5. REFUNDING
6. COMPULSORY REDUCTION OF INTEREST
7. ADDITIONAL TAXATION
8. YEAR WISE PARTIAL REPAYMENT
9. SINKING FUND
10. CAPITAL LEVY

1.REPUDIATION

- Refusal to repay- writing off- credibility issue- only when there is a grave financial crisis- bankruptcy- dangers

2.CONVERSION

Old loans converted into new loans

- High interest loans converted into low interest loans- reduce interest burden
- Borrowers asked to allow conversion –if they do not accept- loans repaid and fresh loans issued

3.UTISATION OF BUDGETARY SURPLUSES

Repurchase govt. bonds with budget surpluses

4. TERMINAL ANNUITY

- Debt repaid in equal annual installments
- Burden decreases every year
- Convenient method

5.REFUNNDING

- Issue new/ fresh bonds to repay old maturing bonds
- Only postponement of repayment
- Also when Interest falls

6. COMPULSORY REDUCTION OF INTEREST RATES

When financial crisis forcefully & unilaterally interest is reduced

7.ADDITIONAL TAXATION

8. YEAR WISE PARTIAL REPAYMENT

Every year part of the debt is repaid- budget should be surplus

9.SINKING FUND

- Huge Walpole –England
- Establishes a separate fund for debt repayment
- Every year part of the revenue transferred to the fund
- Accumulated fund used for repayment on maturity

1. Certain sinking FUND
2. Uncertain Sinking fund

Danger fund may be used for other purposes.

10. CAPITAL LEVY

- Once for all tax on capital goods to raise funds for repayment
- War debt
- Ricardo /Pigou/Dalton

FISCAL FEDERALISM

- Federation: Political system in which there is clearly defined division of sovereignty between central& state govts.
- More than one govt for each region
- Duties& rights of units defied by constitution
- Each independent in its area of jurisdiction
- Established by devolution or aggregation
- Clear demarcation of authority

JUSTIFICATION

- Financial discipline: Fixed financial resources of centre and states. If state depends on cetral funds overspending will be the result
- Efficiency: Main reason. State can do some functions more efficiently than centre and vice versa
- Avoid double taxation: Clear division of revenue sources avoid competitive exploitation of tax payers.
- To solve regional problems: Every region has its own problems and specific problems. Centre cannot solve them

PROBLEMS

- Sharing of tax revenue: Division of resources and functions. States have more functions and less revenue. Tax revenue should be efficiently shared.
- Financial adjustment: Some states rich and others poor. Sothat financial adjustment for balanced devt of all states.

PROBLEMS

- Grants in aid: Grants given by centre to states for balancing gap between revenue sources and expenditures
- To meet revenue gap
- Article 275(1) : grants in aid
- Article 275: grants for scheduled caste devt
- Article282: discretionary grants(flood / famine relief)

PRINCIPLES

- 1.EFFICIENCY
- Revenue collection most efficient- income tax/ building tax
- Problem of income tax if in the statelist-different states , income from different states
- 2UNIFORMITY
- Uniform treatment to all states
- No excessive burden on one state
- No discrimination in expenditure

Principles

3.ECONOMY

Economy in tax collection

Economy in expenditure

No tax evasion

4.AUTONOMY

Each unit independent in raising revenue

Autonomy in raising and spending funds

Autonomy in discharge of duties

PRINCIPLES

- 5.SELF SUFFICIENCY
- Division of resouces to have adequate resources to perform functions
- 6.FLEXIBILITY
- Flexibility to meet the needs of fast changing economy
- 7.ECONOMIC REGULATION
- Tax collection not on revenue consideration alone
- Consider inflation/deflation/growth issues too.

PRINCIPLES

- 8TRNSFER OF RESOURCES
- Some states rich others poor
- So transfer resources from one state to another to achieve national minimum
- 9.ADEQUACY &ELASICITY
- Each unit should have sufficient resources
- Ability to increase & reduce revenue-elasticity

PRINCIPLES

- 10.INTEGRATION&COORDINATION
- Proper integration between constituent units for eco. Devt.
- Proper coordination in every sphere of financial activity
- 11.SUITABILITY
- Tax with narrow base- State
- Broad based taxes- Centre

FISCAL BALANCE
*VERTICAL FISCAL IMBALANCE
*HORIZONTAL FISCAL IMBALANCE

- VERTICAL FISCAL IMBALANCE
- Disproportionate alignment between allocation of specific functions and specific revenue sources
- In India elastic sources of revenue rests with centre-income tax, customs duty,corporation tax
- State govts are charged with large number of duties and responsibilities related to economic development and social welfare
- State revenues inelastic- land revenue, agricultural income tax etc

HORIZONTAL FISCAL IMBALANCE

- Imbalance between units at same levels of govt
- Imbalance among states
- Considerable difference in the distribution of economic resources among states
- Some states have higher pci, wealth and sales with high revenue potential
- Others less developed states

Solutions for vertical fiscal imbalance

- 1.tax sharing-income tax, excise duty
- Loans-central loans to states and vice versa
- Supplementary levies- principal tax levied by centre-additional levy states
- Grants in aid- most important instrument
- To balance between revenue and functions
- Income tax credits on taxes paid to states to promote more tax efforts
- Income tax deductions on taxes paid to states

Solutions for horizontal imbalance

- Budgetary policy to increase per capita consumption of public goods-equalisation policy
- Formation of federation is with implicit understanding of common interest- so residency in poor state cannot be penalised
- Unconditional grants
- Conditional grants
- Interstate redistribution resulting from progressive central taxes- less incidence on poor states
- Resource transfers

FISCAL FEDRALISM IN INDIA

- Indian federal system-result of decentralisation
- 1950 new constitution with federal set up
- Followed division of power as in Govt. of India Act of 1935
- Quasi federal set up with division of powers b/w centre and states
- Residual power of taxation with centre
- 1.Union List
- 2.State List
- 3.Concurrent List

Division of functions

- Powers of centre: List I of 7th schedule of constitution-97 subjects
- Powers of state: List II 66 items
- Concurrent List: 47 Subject
- Conflict: Central Law Supreme

Division of resource

- Taxes with inter state base- centre
- Taxes with local base- states
- Residue- Centre

Classification of taxes

- 1.Taxes levied collected & retained by Centre

-Customs duty, corporation taxes on capital value of assest.

- 2.Taxes levied and collected by centre and proceeds shared b/w centre & states-central excise & income tax

Classification of taxes

- 3.Levied and collected by centre but transferred to states- estate duty, freigt carried by railways,on railway fares.
- 4. levied by union but collected and appropriated by states-stamp duty, excise on toiletories, medicinal preparations