FLEXIBLE BUDGET

Flexible Budgets:

A budget report is prepared to show how actual results compare to the budgeted numbers. It has columns for the actual and budgeted amounts and the differences, or variances, between these amounts. A variance may be favorable or unfavorable. On an income statement budget report, think of how the variance affects net income, and you will know if it is a favorable or unfavorable variance. If the actual results cause net income to be higher than budgeted net income (such as more revenues than budgeted or lower than budgeted costs), the variance is favorable. If actual net income is lower than planned (lower revenues than planned and/or higher costs than planned), the variance is unfavorable. So higher revenues cause a favorable variance, while higher costs and expenses cause an unfavorable variance.

Static budgets

Static budgets are geared to one level of activity. They work well for evaluating performance when the planned level of activity is the same as the actual level of activity, or when the budget report is prepared for fixed costs. However, if actual performance in a given month or quarter is different from the planned amount, it is difficult to determine whether costs were controlled.

Flexible budgets

Flexible budgets are one way companies deal with different levels of activity. A flexible budget provides budgeted data for different levels of activity. Another way of thinking of a flexible budget is a number of static budgets.

Preparation of a Flexible Budget:

The flexible budget uses the same selling price and cost assumptions as the original budget. Variable and fixed costs do not change categories. The variable amounts are recalculated using the actual level of activity, which in the case of the income statement is sales units. Each flexible budget line will be discussed separately.

Sales.

The original budget assumed 17,000 Pickup Trucks would be sold at $15 each. To prepare the flexible budget, the units will change to 17,500 trucks, and the actual sales level and the selling price will remain the same. The $262,500 is 17,500 trucks times $15 per truck. The variance that exists now is simply due to price. Given that the variance is unfavorable, management knows the trucks were sold at a price below the $15 budgeted selling price.

Cost of Goods Sold.

Using the cost data from the budgeted income statement, the expected total cost to produce one truck was $11.25. The flexible budget cost of goods sold of $196,875 is $11.25 per pick up truck times the 17,500 trucks sold. The lack of a variance indicates that costs in total (materials, labor, and overhead) were the same as planned.

Selling Expenses.

The original budget for selling expenses included variable and fixed expenses. To determine the flexible budget amount, the two variable costs need to be updated. The new budget for sales commissions is $10,500 ($262,500 sales times 4%), and the new budget for delivery expense is $1,750 (17,500 units times 10%). These are added to the fixed costs of $12,500 to get the flexible budget amount of $24,750.

General and Administrative Expenses.

This flexible budget is unchanged from the original (static budget) because it consists only of fixed costs which, by definition, do not change if the activity level changes.

Income Taxes.

Income taxes are budgeted as 40% of income before income taxes. The flexible budget for income before income taxes is $20,625, and 40% of that balance is $8,250. Actual expenses are lower because the income before income taxes was lower. The actual tax rate is also 40%.

Net Income.

Total net income changes as the amount for each line on the income statement changes. The net variance in this example is mainly due to lower revenues.

The important thing to remember in preparing a flexible budget is that if an amount, cost or revenue, was variable when the original budget was prepared, that amount is still variable and will need to be recalculated when preparing a flexible budget. If, however, the cost was identified as a fixed cost, no changes are made in the budgeted amount when the flexible budget is prepared. Differences may occur in fixed expenses, but they are not related to changes in activity within the relevant range.

WHAT IS FISCAL CRISIS ?

The fiscal imbalance takes place when the government expenditure exceeds government revenue. This fiscal imbalance is also refered as the fiscal crisis.

FISCAL CRISIS

Government Expenditure > Government Revenue

In 1980, the growing burden of non-development expenditure caused deterioration in the fiscal situation of India. Later this resulted in a fiscal crisis at the beginning of 1991-1992.

❖ Indicators of Fiscal Crisis:

The main indicators of fiscal crisis are various deficits such as :-

Revenue Deficit (RD) : It is the difference between revenue receipts (income) and revenue expenditure.

Budgetary Deficit (BD) : It is the difference between total expenditure and total receipts. Here, both revenue and capital expenditure and receipts are considered.

Fiscal Deficit (FD) : It is the excess of total expenditure over revenue receipts and grants. In other words, fiscal deficit is the budget deficit plus government borrowings and other liabilities.

Primary Deficit (PD) : It is the fiscal deficit minus interest payments.

Central Government of India's Deficit

(As Percentage of GDP at Current Prices - Base 1993-94 Prices)

Year	*Revenue Deficit*	*Fiscal Deficit*	*Primary Deficit*
1990 – 91	3.3	6.6	2.8
1995 – 96	2.5	4.2	0.0
1999 – 00	3.5	5.4	0.7
2005 - 06	2.7	4.1	0.4

Source - Based on Economic Survey 2006-07

From the above table, it is clear that fiscal deficit is about 4.1% of GDP. Overall the revenue deficit has declined from 3.3% in 1990-91 to 2.7% of GDP in 2005-06.

❖ Causes of Fiscal Crisis:

The main factors responsible for the fiscal crisis in India are as follows :-

1. Increase in Subsidies:

The government has been providing subsidies on a number of items such as fertilizers, exports, food items, etc. This has resulted in a fiscal imbalance. The major subsidies provided by the Central Government of India has increased over the years resulting in fiscal imbalance.

The increase in subsidies by the central government is given in data below :-

Subsidies - Central Government of India

Year	Rs. Crore
1990-91	9,581
2006-07	44,792

Source : Economic Survey 2006-07

2. Payment of Interest:

One of the major components of government expenditure is the interest payment both on domestic loans and foreign loans. The government debt has increased considerably over the years. This has resulted in increased interest burden on the government.

Interest payment of the Central Government increased from Rs. 21,500 crores in 1990-91 to Rs. 1,39,823 crores in 2006-07.

3. Defence Expenditure:

The defence expenditure is increasing over the years. The government has limited scope to reduce defence budget due to security problems across the Indian borders. The defence expenditure on the part of central government has increased from Rs. 10,874 crores in 1990-91 to Rs. 51,542 crores in 2006-07.

4. Poor Performance of Public Sector:

The poor performance of public sector has also resulted in fiscal imbalance. The poor performance of public sector is due to various reasons such as political interference, inefficiency and corruption of management, low labour efficiency, lack of professionalism, surplus staff, etc.

Due to poor performance of public sector, the Government gets low revenue by way of dividend from public sector units.

5. Excessive Government borrowings:

The internal and external debt of the government has increased considerably during the past few decades. Due to the debts; the government has to incur high expenditure in form of interest payments.

6. Tax Evasion:

Indian tax system is made up of complex procedures with numerous exemptions. Corruptions is rampant at all levels, which leads to the fiscal imbalance.

7. Weak Revenue Mobilisation:

While increase in government expenditure has been the major cause of fiscal imbalance, inadequate rise in revenue receipts also contributed to fiscal imbalance. The revenue receipts of the

centre, consisting of tax revenue, net of state's share and non-tax revenue, has increased at slower rate than that of growth in expenditure.

8. Huge Borrowings:

The gap between expenditure and revenue is financed through loans, both internal and external. The borrowings have been spent on unproductive purposes as well. The huge borrowings resulted in large interest payments.

9. Other Causes:

Unproductive expenditure by the government, Weak resource mobilisation and Low Capital Formation.

❖ Consequences of Fiscal Crisis :

The fiscal imbalance has resulted in harmful consequences like mounting inflation, deficit in balance of payment, etc. It has also adversely affected the growth of economy. The government must introduce major fiscal correction policies to overcome the fiscal crisis.

The consequences of fiscal crisis i.e. a sustained high fiscal deficits over 20 years are as follows :-

1. Debt Trap:

With increasing levels of borrowing for financing activities, which have zero or low yields, interest payments increase at faster rate. Thus, non-productive expenditures rise, give rise to higher and higher revenue deficits.

2. Cut in Capital Expenditure:

Because of debt service payments forming a higher proportion of expenditures, all other activities of the government suffer. The main sufferer in this process is government capital expenditure in both economic and social infrastructure.

3. No Increase in Expendture on Education and Health:

High debt service payments also prevents increase in or even maintenance of real expenditure on social services, i.e. on education and public health.

4. High Interest Rates:

The continued high level of public borrowings has an effect on the rest of the economy through prevalence of high interest rates.

5. Slow Economic Growth:

The fiscal imbalance affects economic growth in the country. Fiscal imbalance first affects capital formation which in turn affects the economic growth.

6. Other Consequences:

Some other consequences of fiscal crisis are :-

Fiscal imbalance may also lead to inflation in the economy.

High fiscal deficit may discourage foreign investment in the country.

The government has to borrow additional funds to solve fiscal deficit, which put extra burden on the government for payment of interest. It further worsens the fiscal imbalance.

Conclusion On Fiscal Crisis :

The fiscal imbalance however still continue as the Government has failed to reduce its own expenditure. The extravagant expenditure done by politicians and minister continues without any restriction. The populist policy followed by the Government, failure to reduce fertilizer subsidy, and massive burden of interest payment has still not take out the Indian economy from a situation of severe fiscal imbalances.

Fiscal Sector Reforms

India's fiscal sector reforms help to raise the rate of savings and investments in India, which further enhances the productivity of public expenditure.

Components of India's Fiscal Sector Reforms

1.expenditure reforms:

2.tax reform measures:

3.public sector restructuring:

4.government's borrowing process:

PUBLIC EXPENDITURE

MEANING OF PUBLIC EXPENDITURE:-

Public Expenditure refers to Government Expenditure. It is incurred by Central and State Governments. The Public Expenditure is incurred on various activities for the welfare of the people and also for the economic development, especially in developing countries. In other words The Expenditure incurred by Public authorities like Central, State and local governments to satisfy the collective social wants of the people is known as public expenditure.

A. NEED I IMPORTANCE/ SIGNIFICANCE OF PUBLIC EXPENDITURE :-

In modern economic activities public expenditure has to play an important role. It helps to accelerate economic growth and ensure economic stability. Public Expenditure can promote economic development as follows :-

1. To promote rapid economic development.
2. To promote trade and commerce.
3. To promote rural development

4. To promote balanced regional growth
5. To develop agricultural and industrial sectors
6. To build socio-economic overheads eg. roadways, railways, power etc.
7. To exploit and develop mineral resources like coal and oil.
8. To provide collective wants and maximise social welfare.
9. To promote full - employment and maintain price stability.
10. To ensure an equitable distribution of income.

Thus public expenditure has to create and maintain conditions conducive to economic development. It has to improve the climate for investment. It should provide incentives to save, invest and innovate.

B. OBJECTIVES OF PUBLIC EXPENDITURE :-

The major objectives of public expenditure are

1) Administration of law and order and justice.
2) Maintenance of police force.
3) Maintenance of army and provision for defence goods.
4) Maintenance of diplomats in foreign countries.
5) Public Administration.
6) Servicing of public debt.
7) Development of industries.
8) Development of transport and communication.
9) Provision for public health.
10) Creation of social goods.

In a modern welfare state, the importance of public expenditure have increased. The total Central Government's expenditure (Revenue and Capital) rose from Rs. 98,272 crores in 1990-91 to Rs. 10,18,526 crores in 2009-10.

❖ CLASSIFICATION / TYPES OF PUBLIC EXPENDITURE :-

Classification of public expenditure refers to the systematic arrangement of different items on which the government incurs expenditure. Public expenditure can be classified as follows :-

PUBLIC EXPENDITURE

Capital And	Productive And	Transfer And	Plan And	Other Classification

Revenue Non-Productive Non – Transfer Non - Plan

1) Capital And Revenue Expenditure :-

Capital Expenditure of the government refers to that expenditure which results in creation of fixed assets. They are in the form of investment. They add to the net productive assets of the economy. Capital Expenditure is also known as development expenditure as it increases the productive capacity of the economy. It is an investment expenditure and a non-recurring type of expenditure. For Eg. Expenditure - on agricultural and industrial development, irrigation dams, public -enterprises etc, are all capital expenditures

Revenue expenditures are current or consumption expenditures incurred on civil administration, defence forces, public health and , education, maintenance of government machinery etc. This type of "expenditure is of recurrent type which is incurred year after year.

2) Development And Non - Developmental Expenditure / Productive And Non - Productive Expenditure :-

Expenditure on infrastructure development, public enterprises or development of agriculture increase productive capacity in the economy and bring income to the government. Thus they are classified as productive expenditure. All expenditures that promote economic growth development are termed as development expenditure.

Unproductive (non - development) expenditure refers to those expenditures which do not yield any income. Expenditure such as interest payments, expenditure on law and order, public administration, do not create any productive asset which brings income to government such expenses are classified as unproductive expenditures.

3) Transfer And Non - Transfer Expenditure :-

Transfer expenditure refers to those kind of expenditures against there is no corresponding transfer of real resources i.e., goods or services. Such expenditure includes public expenditure on :- National Old pension Scheme, Interest payments, subsidies, unemployment allowances, welfare benefits to weaker sections etc. By incurring such expenditure, the government does not get anything in return, but it adds to the welfare of the people, especially to weaker sections of society. Such expenditure results in redistribution of money incomes within the society.

The non - transfer expenditure relates to that expenditure which results in creation of income or output The non - transfer expenditure includes development as well as non - development expenditure that results in creation of output directly or indirectly. Economic infrastructure (Power, Transport, Irrigation etc.), Social infrastructure (Education, Health and Family welfare), Internal law and order and defence, public administration etc. By incurring such expenditure, government creates a healthy environment for economic activities.

4) Plan And Non - Plan Expenditure

The plan expenditure is incurred on development activities outlined in ongoing five year plan. In 2009-10, the plan expenditure of Central Government was 5.3% of GDP. Plan expenditure is incurred on Transport, rural development, communication, agriculture, energy, social services, etc.

The non - plan expenditure is incurred on those activities, which are not included in five-year plan. It includes development and non - development expenditure. It includes :-Defence, subsidies, interest payments, maintenance etc.

5) Other Classification (Mrs. Hicks)

Mrs. Hicks classified Public Expenditure on the basis of duties of government. It is as follows :-

a) Defence Expenditure :-

It is expenditure on defence equipments, wages and salaries of armed forces, navy and airforce etc. It is incurred by government to provide security to citizens of country from external aggression.

b) Civil Expenditure :-

Government/incurs this expenditure to maintain law and order and administration of justice.

c) Development Expenditure :-

It is expenditure on development of agriculture, industry, trade and commerce, transport and communication etc.

A) IS All PUBLIC EXPENDITURE GOOD FOR AN ECONOMY? :-

Public Expenditure if properly utilised is good for an Economy

1) Public Expenditure must be productive and used for developmental purposes.

2) A proper authority should give the approval of public expenditure.

3) Auditing of public expenditure should be done to ensure that money is spent for the purpose for which it is sanctioned.

4) Public Expenditure should be incurred on essential items of common benefit.

5) Public expenditure should promote flexibility and changes in spending policy of the state.

6) There should be flexibility and changes in spending policy of the state.

Thus, the spending policy of the government must give benefits to the society as a whole.

Q.3: Give Reasons for increase in Public expenditure in India (M-11) OR

Explain the causes for rising trend in public expenditure in recent years? OR

Write note on causes of growth of Public Expenditure in India.

A) CAUSES OF INCREASE IN PUBLIC EXPENDITURE IN INDIA :-

During the planning period, the expenditure of Central and State Government's have increased. The Central Government's expenditure has increased over 10 times. Lets see

CENTRAL GOVERNMENTS EXPENDITURE

(Revenue & Capital)

Year	Rs. Crore	% of GDP
1990-91	98,272	17.3
2004-05	4,98,252	15.4
2009-10	10,18,526	15.5

Source :- Economic Survey 2010-11

The following are the main causes of growth of public expenditure in India :-

1) Growing Population :-

A high growth of population naturally calls for increase in public expenses as all state functions are to be performed more extensively^ Population growth has made necessary for governments of most countries to spend increasing amounts on education, health, infrastructure, subsidies and social security. In 2011, :he population of India has increased to 121 crores.

POPULATION OF INDIA

Year	Rs. Crore
1951	36.1
2001	102.9
2011	121.0

Source :- Economic Survey 2010-11

2) Defence Expenditure :-

The defence expenditure of the Central Government has increased over the years. The defence expenditure minimises the possibility of external threats, which in turn creates a good environment for social and economic activities of the nation. In India Defence expenditure has increased from Rs. 10,874 crores in 1990-91 to Rs. 90,688 crore in 2009-10.

DEFENCE REVENUE EXPENDITURE (Central Govt.)

Year	Rs. Crore
1990-91	10, 874
2009-10	90,668

Source :- Economic Survey 2010-11

3) Interest Payments :- ,

Government borrowings are on increase. The government borrows funds from domestic market and foreign sources to meet expenditure on various government activities. As a result, the government has to incur huge interest payments. The interest payments of Central Government has increased from Rs. 21,498 crores in 1990-91 to Rs. 2,11,643 crores in 2009-10.

INTEREST PAYMENTS (Central Govt.)

Year	Rs. Crore
1990-91	21,498
2009-10	2,11,643

Source :- Economic Survey 2010-11

4) Subsidies :-

Government of India has been providing subsidies on number of items such as food, fertilizers, fuels, education etc. Because of massive amount of subsidies, the government expenditure has increased over the years. In 1990-91 the Central Government's subsidies was Rs. 9,581 crores which increased to Rs. 1,23,396 crores in 2009-10. In order to reduce unproductive expenditure, Central Government must make attempts to reduce subsidies.

MAJOR SUBSIDIES (Central Govt.)

Year	Rs. Crore
1990-91	9,581
2009-10	1,23,396

Source:- Economic Survey 2010-11

5) Administration :-

The Central Governments expenditure on administration has increased due to growth in population and economic development. Government incurs on law and order, tax administration, civil administration etc. Due to inflation the government has to revise the payscale periodically. The production cost of public goods and services has also risen due to rising prices.

6) Rise In National Income :-

The national income of the country has increased over the years. The increase in national income resulted in more revenue to the government by way of tax revenue and other income, which in turn enabled the government to increase its expenditure. For Eg. From 1980-81 to 2007-08, the N.I. has increased at the rate of 5.7% p.a. Percapita Income has also risen.

7) Urbanisation :-

Urbanisation has led to increasing expenditure on civil administration. Government expenditure on courts, police, transport, railways, schools and colleges, public health measures, water and electricity supply, public parks, libraries etc. have increased due to growth of towns and cities.

8) Rural Development :-

In developing countries, government has to undertake community development projects and other social measures to promote rural development. Such measures cause a rise in public expenditure.

9) Inflation :-

Rise in prices have caused an increase in public expenditure. The cost of supplying public goods and services has increased. Rising prices have also necessiated the payment of higher salaries and dearness allowances.

10) Democratic Government :-

A democratic government has to incur increasing expenditure on elections, legislatures, ministries, international conferences, embassies abroad etc. Public expenditure also increases when a country becomes a member of international organisations like UNO, WHO etc.

11) Social Security Measures :-

For the welfare of the people government provides social security measures which increases its expenditure. It provides measures such as sickness benefits, old - age pensions, free education, medical facilities, public works and relief programmes etc.

12) Growth Of Transport And Communication :-

The government has to incur huge expenditure on construction of railways, roadways, national highways, bridges etc. to promote mobility and economic development. Thus with growth of transport and v-communication public expenditure have increased.

13) Development Of Agriculture :-

The government may develop agriculture by providing seeds,

fertilisers, irrigation facilities, modern implements, cheap loans etc. All these will increase public expenditure.

14) Development Of Industry :-

The government may encourage the growth of private sector industries through protection, subsidies to exporters, loans at cheap rate of interest etc. causing a rise in public expenditure

15) Poverty Alleviation Programmes :-

In developing countries, governments are spending a good amount of funds on poverty alleviation and employment generation programmes. Some of the programmes are Swarnajayanti Gram Swarojgar Yojana, Indira Awas Yojana, National Food for Work Programme etc.

16) Research And Development :-

Research and Development is important to improve quality and to reduce costs. The government finances Research and Development projects undertaken by non - government organisations, universities and i other educational organisations.

17) Economic Planning :-

To promote rapid economic development modern governments adopt economic planning. The public sector outlay on various sectors has been increasing with the increasing role of government.

PUBLIC DEBT

Q. 1: Explain the concept and classification of public debt. OR

Explain the meaning and types of Public Debt.

❖ CONCEPT OF PUBLIC DEBT

Public debt refers to government debt. It refers to Government borrowings from individuals, financial institutions, organisations and foreign countries. If revenue collected through taxes and other sources is not adequate to cover expenditure, the government may resort to borrowings. Thus public debt is one of the instruments to cover deficits in budget.

Over the years, the public debt of Central Government and that of State Government's has increased during the planning period. In short, public debt refers to "obligations of governments, particularly those evidenced by securities, to pay sums to the holders at some future date". Borrowed funds are utilised for development and non-development activities. -

The following table shows the outstanding public debt of Central Government:-

CENTRAL GOVERNMENT DEBIT (Crore)

Debt	1990-91	2009-10
Internal. External	1,54,004 31,525	23,37,682 1,39,581
Total	1,85,529	24,77,263

Source:- Economic Survey 2010-11

The Central Governments debt has increased by 13.4 times between 1990-91 and 2009-10. In 2009-10, the outstanding debt of Central Government was 40.4% of GDP. Internal debt was 35.8% and External debt was 2.1%.

❖ CLASSIFICATION / TYPES OF PUBLIC DEBT

1) Internal And External Debt

a) Internal Debt :-

Government borrowings within the country are known as internal debt. Public loans floated within the country are called internal debt. The various internal sources from which the government borrows include individuals, banks, business firms and others. The various instruments of internal debt include market loans, bonds, treasury bills, ways and means advances etc. An internal debt may be either voluntary or compulsory. Internal debt imply a redistribution of income and wealth within the country and therefore it has no direct money burden. Over the years the internal debt of Central Government has increased from ? 1,54,004 crore in 1990-91 to Rs. 23,37,682 crore in 2009-10.

b) External Debt :-

Borrowings by the government from abroad is known as external debt. The external debt comprises of:- Multilateral borrowings, Bilateral borrowings, Loans from World Bank, Asian Development Bank, etc. External loans help to take up various developmental programmes in developing and underdeveloped countries. These loans are usually voluntary. Initially an external loan involves a transfer of resources from foreign countries to domestic country but, when interest and principal amount are being repaid a transfer of resources takes place in reverse direction. Over the years the external debt of Central Government has increased from Rs.31,525 crore in 1990-91 to Rs. 1,39,581 crore in 2009-10.

2) Short Term. Medium Term And Long - Term Debt :-

a) Short Term Debt :-

Loans for a period of less than one year are known as short - term debt. For Eg. The treasury bills are issued by RBI on behalf of the government to raise funds for a period of 91 days and 182 days. Interest rates on such loans are very low. To cover the temporary deficits in budget short - term loans are taken.

b) Medium - Term Debt

The period of medium term debt is normally for a period above one year and upto 5 years. One of the main forms of medium term debt is by way of market loans. The interest rates on medium term loans are reasonable. These are preferred to meet expenditure on health, education, relief work etc.

c) Long - Term Debt

Loans for a period exceeding 5 years are called long - term debt. One of the main forms of long term loans is by way of issue of bonds. Long term debt is required for the purpose of retirement of debts and also for the purpose of development projects.

3) Productive And Unproductive Debt

a) Productive Debt

Public debt is said to be productive when it is raised for productive purposes and is used to add to the productive capacity of the economy. These loans are normally long - term in nature. These loans are utilised on development activities such as infrastructure development like roadways, railways, airports, seaports, power generation, telecommunications etc. The productive debts are self - liquidating in nature, this means the principal amount and interest are normally paid out of the revenue generated from the projects to which the loans were utilised.

b) Unproductive Debt

An unproductive debt is one which does not yield any income. It does not add to the productive assets of the country. For Eg. debts utilised for transfer payments in form of subsidies, old age pension, special incentives to weaker sections etc. Unproductive public loans are a net burden on the community. The government will have to resort to additional taxation for their servicing and repayment.

4) Compulsory And Voluntary Debt

a) Compulsory Debt

Normally, the government does not obtain funds through compulsory means. The government may obtain such loans from banks, financial institutions and large corporate firms at time of war or major disaster, only when it is not possible to obtain voluntary debt. In India, Compulsory Deposit Scheme is an example of compulsory debt.

b) Voluntary Debt

Generally, public loans are voluntary in nature. The voluntary debt may be obtained in the form of Market loans, bonds etc. People invest in voluntary debts from the point of view of liquidity and profitability. The rate of interest is normally higher than that of compulsory debt.

5) Redeemable And Irredeemable Debt

a) Redeemable Debt

Loans which government promises to pay off at some future date are called redeemable debts. Their maturity period is fixed. The government has to make arrangements to repay the principal and interest on due date. These loans are repaid out of revenue receipts of government or by raising further loans.

b) Irredeemable Debt

Loans for which no promise is made by the government regarding their exact date of repayment are called irredeemable debts. Such debt has no maturity period. The government may pay interest regularly. Normally, government does not resort to such borrowings.

6) Funded And Unfunded Debt

a) Funded Debt

Funded debt is normally obtained on long - term basis. The interest on funded debt must be paid regularly. But the government has the option to repay the principal. If market conditions are favourable government may repay it before maturity. Funded debt comprises of securities which are marketable on stock exchange.

b) Unfunded Debt

Unfunded debts are of short term. They are also known as floating debt. Unfunded debts are incurred to meet temporary needs of the government. The rate of interest is low. There is no special fund created to repay this debt.

Q.2): Explain the trends and composition of public debt in India. OR

Explain the debt obligation of Central Government.

A) COMPOSITION AND GROWTH I TRENDS OF PUBLIC DEBT IN INDIA

During recent years public debt in India has been growing at an alarming rate, with the budget deficit increasing significantly. Debt obligation of Central Government are divided into internal liabilities and external debts. The following are the various components of public debt :-

(I) Internal Debt:-

Internal debt refers to loans raised from open market. Internal debt of Central Government has increased from Rs.1,54,004 crores in 1990-91 to Rs.23,37,682 crores in 2009-10.

INTERNAL DEBT LIABILITIES OF GOVERNMENT OF INDIA

Year	Rs. Crore	% of GDP'
1990-91	1,54,004	28.8
2009-10	23,37,682	35.7

Source:- Economic Survey 2010-11

Internal debt includes the following:-

1. *Market Loans :-*

Market loans have a maturity period of 12 months or more and they generally bear interest. These loans are raised in the open market by sale of securities or otherwise. Market loan stood at 17,34,505 crore in 2009-10.

2. *Treasury Bills*

This is a major source of short term funds for the government to bridge the gap between revenue and expenditure. They have a maturity of 91 days, 181 days and 364 days Treasury bills are issued to the Reserve Bank of India, State Governments, Commercial Banks and other parties.

3. *Securities Against Small Savings :-*

Under the new Accounting System of National Small Savings Funds (NSSF), a substantial part of small savings have been converted into Central Government Securities from the year 1999 - 2000. As a result, there has been a sharp rise in internal debt and the corresponding decline in other liabilities in form of small savings.

4. *Special Securities Issued Bv RBI :-*

The Government obtains temporary loans for a period of maximum 12 months from RBI and issues special securities, which are non-negotiable, and non-interest bearing.. Such securities provide short term funds to the Government.

5. *Special Floating And Other Loans :-*

It refers to the contribution of government towards the capital of International Financial Institutions such as International Monetary Fund, International Bank for Reconstruction and Development, and International Development Association. These are non - negotiable and non - interest bearing securities and the Government of India is supposed to make repayment at the call of these institutions.

6. *Bonds And Expired Loans :-*

It comprises balance of expired loans, gold bonds and compensation and other bonds such as National Rural Development Bonds, Central Investment Bonds. The bonds are issued at different maturity periods which may range from 3 year to 10 year period

7. *Ways and means Advances:-*

The government of India takes ways and means advances from RBI to meet its short period expenditure.

II) Other Internal Liabilities

Apart from internal borrowings, the government also obtains funds from following :-

1) Small Savings :-

Schemes like National Savings Certificates, National Savings Scheme etc. contributed to rise in small savings. These schemes provide tax concessions to tax payers. As a result they have been successful in attracting more funds in small savings.

2) Provident Funds :-

Provident funds are divided into two categories State Provident Fund and Public Provident Fund. Deposits in Public Provident Funds are repayable after 15 years.

3) Reserve Funds And Deposits :-

Reserve Funds and Deposits are divided into two categories - interest bearing and non interest bearing. They include depreciation and reserve funds of railways and department of posts and department of telecommunications, deposits of local funds, departmental and judicial deposits, civil deposits etc.

III) External Debt

The government obtains funds not only from internal sources but also from external sources. External debt has increased from Rs.31,525 crore in 1990-91 to Rs. 1,39,581 crore in 2009-10.

EXTERNAL DEBT OUTSTANDING OF CENTRAL GOVERNMENT

Year	Rs Crore	% of GDP
1990-91	31,525	5.9
2009-10	1,39,581	2.1

Source :- Economic Survey 2010-11

According to Global Development Finance Report 2009, India is ranked as 7th largest debtor country in the world. This is a huge burden.

Long Term Debt comprises of Multilateral borrowings, Bilateral borrowings, loans from World Bank etc. The government also borrows funds from external sources for short-term period. In 2009-10, the short term external debt was about 20% of total external debt of Central Government.

Q. 3 : Discuss the burden of public debt. OR Explain the burden of Internal and External debt.

A. BURDEN OF PUBLIC DEBT

To meet various expenses government borrows funds by way of public debt. Over the years the Central Government's Outstanding debt has increased by 13.4 times between 1990-91 and 2009-10. public debt puts a burden on the economy on account of repayment of principal amount and interest. Both internal as well as external debt carries a burden on the economy.

(I) Burden Of Internal Debt

Internal debt puts burden on the citizens and on the social and economic development of the nation. Internal debt constitutes a redistribution of resources within the community. There is no change in total resources of the country. The burden of internal debt is explained as follows

1. Direct Money Burden

There is no direct money burden on the country as the repayment of principal amount and the interest involves a transfer of purchasing power from one set of people to another within the country. Thus the aggregate position of the community remains the same.

2. Direct Real Burden

The direct real burden is on the economy. It is measured in terms of loss of welfare suffered by the citizens depending upon the proportion in which various members of the society contribute towards repayment of loan and interest. Some economists argue that the direct real burden falls on future generations.

3. Indirect Real Burden

Internal debt also has indirect real burden. Higher taxes may de-motivate the tax payers to work hard for higher incomes. This may have an adverse effect on productive activities in the country.

4. Inflation

If indirect taxes are raised for repayment of internal debt, then inflation may take place. Inflation will reduce the purchasing power of the poor.

5. Unjustified Transfers

The servicing of internal debt involves transfer of income from younger generations to older generations and from active to inactive enterprises.

6. Effect On Private investment

Internal debt may indirectly affect private investment. Internal debt involves huge interest payments. Therefore, lesser funds are available with the Government for development activities such as infrastructure. Lack of infrastructure development discourages private investment, which affects economic growth.

7. Effect On Social Development

Due to internal debt, there is higher interest burden. Higher burden results in availability of lower funds towards social development activities like health, education, family welfare, etc.

(II) Burden Of External Debt

External debt is beneficial in the initial stages as it increases the resources available to the country. But its repayment and servicing creates a burden on the debtor country.

1. Direct Money Burden

External debt creates direct money burden. This is because it involves transfer of funds from the debtor country to foreign citizens. The degree of burden depends upon the interest rate and loan amount.

2. Direct Real Burden

Direct real burden is the loss of economic welfare i.e. the sacrifice of the consumption of goods and services due to increased taxation. I The foreign currency earned through exports would have been

utilised to import better goods and technology, which would have increased the I economic welfare of the citizens of debtor country. But because of external I debt repayment, they have to restrict their welfare which the imported I goods would have provided.

3. Indirect Money And Real Burden

This is measured in terms of effects on production and allocation of resources. To repay public debt, the government may increase taxes or reduce public expenditure. These will cause reduction in production I and consumption. This is indirect money and real burden of external debt.

4. Problem Of Debt Trap

Certain countries borrow heavily from external sources. Quite often, borrowed funds are utilised for non development and unproductive purposes. Sometimes, highly indebted countries borrow funds to repay the earlier debts. Such heavy borrowings to repay earlier debts put highly indebted countries in external debt trap. Recent example of 2010 crisis are European nations such as Portugal, Italy, Span and Ireland. Also Dubai debt crisis did have an effect on International community.

5. Burden Of Unproductive Foreign Debt

If the external debt is incurred for unproductive purposes, it will create a greater burden and sacrifice on the citizens of the debtor country.

6. Burden On Foreign Exchange Reserves

The repayment of external debt puts a burden on foreign exchange reserves of a country. During international crisis, there is often a contagion (spreading) effect, this means, if one country is affected, the other countries are also affected. Thus it is advisable to have good foreign exchange reserves, so that the country does not come into contagion effect, as the investors will have confidence in the economy and may not withdraw their investment.

7. Domination Bv Creditor Country

The creditor country may dominate the debtor country in various spheres. The debtor country may be forced to take decisions which may generate more benefits to the creditor country.

B. CONCLUSION

Thus from above we can say that internal as well as external debt create burden on the community. Internal debt is considered less burdensome as compared to external debt.