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Paper- MJC 9 (Public Finance)
Topic- Methods of paying Public Debt

Methods of Paying Public Debt:

If a government wishes to escape from the burden of the debt, then there are two ways open to it. It may (i) repudiate its debt, (ii) repay them.

If the public authority decides to repudiate the debt, then it loses the confidence of the people living in the country and of the foreign governments. There is also every likelihood that in case of foreign debt repudiation, the foreign states may take military action to recover the loan or boycott the repudiating government. So in order to avoid this degrading situation, every debtor country tries to own its obligation. The main methods which are adopted to pay/reduce or wipe off the public debt are as follows:

(i) Sinking Funds:

The Sinking Fund is a very important method for the redemption of public debt. It is a fund which is created out of the general revenue for paying off the loans every year. The debtor

country during the life of debt sets apart a portion of the current revenue every year. When the sum thus accumulated becomes equal to the loan raised, it pays off the entire debt in one installment.

(ii) Terminable Annuities:

If a debtor country wishes to repay a permanent debt, it may do so by fixing installments over a period of years. These installment repayments are known as annuities.

(iii) Utilization of Surplus Budget:

If during a particular year, the country has a surplus budget, it can be utilized in reducing the burden of the debt. It is true that surpluses can be used for redeeming the public debt, but favorable budgets are not common with the debtor countries. If at all there is any surplus any year, it is generally so small. It cannot make any significant reduction in the national debt.

(iv) Redemption by the Purchase of Government Stock:

A Government can also lessen the burden of debt by the purchase of its own stocks in the market. These stocks can be brought by fresh borrowing at low rates or by the utilization of surplus revenues.

(v) Conversion:

Another very important method for reducing the burden of the public debt is to convert a loan bearing a high rate of interest into another with a lower rate of interest. Conversion as stated by Dalton is not repayment, it is only the exchange of new debt for old. If a state has contracted a loan when the rate of interest was high, it can reduce the annual interest payment by conversion operation.

(vi) Capital Levy:

Another important method which has been suggested by economists for wiping off the public debt is the institution of a special debt redemption levy as is generally called. The advocates of capital levy state that it is not possible to reduce the burden of war debt by means of a sinking fund or surplus revenues or by annuities, etc. The state should levy a special tax on the accumulated wealth or capital of the people at a progressive rate and with the money thus raised pay off all the war debts. Dalton in his book 'Public Finance' Writes:

"For just as during the war a law was passed which every man of suitable age and physique was deemed to be a soldier, so now in order to dissipate one of the evil legacies of War finance, a law would be passed by which every man of suitable degree of wealth would be deemed to die and to come to life again next morning as the fortunate heir of his own property on payment of an appropriate ransom".

(vii) Surplus Balance of Payments:

A government can pay off debt by increasing exports and reducing imports. The surplus balance can be used to lessen the burden of debt.

(viii) Writing off loans:

The government can also request the credited countries to write off loans.