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Topic: Public Debt and Classification of Public Debt

Public Debt

Meaning :

Public debt is the total amount, including total liabilities, borrowed by the government to meet its development budget. It has to be paid from the **Consolidated Fund** of India. *The term is also used to refer to overall liabilities of central and state governments, but the Union government clearly distinguishes its debt liabilities from the states'.*

Classification of Public Debt:

The structure of public debt is not uniform in any country on account of factors such as categories of markets in which loans are floated, the conditions for repayment, the rate of interest offered on bonds, purposes of borrowing, etc.

In view of these differences in criteria, public debt is classified into various categories:

- i. Internal and external debt
- ii. Short term and long term loans
- iii. Funded and unfunded debt

iv. Voluntary and compulsory loans

v. Redeemable and irredeemable debt

vi. Productive or reproductive and unproductive debt/deadweight debt

i. Internal and External Debt:

Sums owed to the citizens and institutions are called internal debt and sums owed to foreigners comprise the external debt. Internal debt refers to the government loans floated in the capital markets within the country. Such debt is subscribed by individuals and institutions of the country.

On the other hand, if a public loan is floated in the foreign capital markets, i.e., outside the country, by the government from foreign nationals, foreign governments, international financial institutions, it is called external debt.

ii. Short term and Long Term Loans:

Loans are classified according to the duration of loans taken. Most government debt is held in short term interest-bearing securities, such as Treasury Bills or Ways and Means Advances (WMA). The maturity period of a Treasury bill is usually 90 days.

The government borrows money for such a period from the central bank of the country to cover temporary deficits in the budget. Only for long term loans, the government comes to the public. For development purposes, long period loans are raised by the government usually for a period exceeding five years or more.

iii. Funded and Unfunded or Floating Debt:

Funded debt is the loan repayable after a long period of time, usually more than a year. Thus, funded debt is long term debt. Further, since for the repayment of such debt the government maintains a separate fund, the debt is called funded debt. Floating or unfunded loans are those which are repayable within a short period, usually less than a year.

It is unfunded because no separate fund is maintained by the government for the debt repayment. Since repayment of unfunded debt is made out of public revenue, it is referred to as a floating debt. Thus, unfunded debt is a short term debt.

iv. Voluntary and Compulsory Loans:

A democratic government raises loans for the nationals on a voluntary basis. Thus, loans given to the government by the people on their own will and ability are called voluntary loans. Normally, public debt, by nature, is voluntary. But during emergencies (e.g., war, natural calamities, etc.) the government may force the nationals to lend it. Such loans are called forced or compulsory loans.

v. Redeemable and Irredeemable Debt:

Redeemable public debt refers to that debt which the government promises to pay off at some future date. After the maturity period, the government pays the amount to the lenders. Thus, redeemable loans are called terminable loans.

In the case of irredeemable debt, the government does not make any promise about the payment of the principal amount, although interest is paid regularly to the lenders. For the most obvious reasons, redeemable public debt is preferred. If irredeemable loans are taken by the government, the society will have to face the consequence of the burden of perpetual debt.

vi. Productive (or Reproductive) and Unproductive (or Deadweight) Debt:

On the criteria of purposes of loans, public debt may be classified as productive or reproductive and unproductive or deadweight debt. Public debt is productive when it is used in income-earning enterprises. Or productive debt refers to that loan which is raised by the government for increasing the productive power of the economy.

A productive debt creates sufficient assets by which it is eventually repaid. If loans taken by the government are spent on the building of railways, development of mines and industries, irrigation works, education, etc., income of the government will increase ultimately.

Productive loans thus add to the total productive capacity of the country.

In the words of *Findlay Shirras*: “Productive or reproductive loans which are fully covered by assets of equal or greater value, the source of the interest is the income from the ownership of these as railways and irrigation works.”

Public debt is unproductive when it is spent on purposes which do not yield any income to the government, e.g., refugee rehabilitation or famine relief work. Loans for financing war may be regarded as unproductive loans. Instead of creating any productive assets in the economy, unproductive loans do not add to the productive capacity of the economy. That is why unproductive debts are called **dead weight debts**.