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Topic – Public Debt and its type.

Public debt or public borrowing is considered to be an important source of income to the government. If revenue collected through taxes and other sources is not adequate to cover government exp1enditure, government may resort to borrowing.

Public debt may be raised internally or externally. Internal debt refers to public loans floated within the country, while external debt refers loans floated outside the country.

Loans taken by the government may be from individuals, banks, financial institutions like the International Monetary Fund, World Bank etc. The instruments of public debt take the form of government bonds or securities of various kinds.

Types of public Debt:

Government loans are of different kinds. They may differ in respect of time of repayment, the purpose, conditions of repayment, place of their floating and the method of covering the liability. Thus public debt may be classified into following types.

1. **Internal and External Debt:**
   The internal loans are raised within the country and subscribed mainly by its own citizens and/or institutions. It is repayable only in domestic currency. 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. External loans are raised from foreign countries or international institutions. These loans are repayable in foreign currencies. External loans help to take up various development programme in developing and underdeveloped countries. These loans are usually voluntary. An external loan involves, initially a transfer of resources from foreign countries to the domestic country but when interest and principal amount are being repaid a transfer of resources takes place in the reverse direction.

2. **Voluntary and Compulsory debt:**
   Public debts may be incurred through voluntary or compulsory loans. Generally, public loans are voluntary in nature. In this case the government makes an announcement regarding the floating of loans. This announcement may be accompanied by some kind of

publicity. The government floats a loan by issuing certificates, bond, etc. Individuals, banks and other financial institutions lend to the government willingly by purchasing these securities. On the other hand, compulsory loans are those which are raised by using coercive methods. A compulsory loan is a rare phenomenon in modern public finance unless there are some special circumstances like war or crisis. The rate of interest on such loans may be low. Considering the compulsion aspect, these loans resemble a tax, the only difference is that loans are repaid but tax is not. In India, Compulsory Deposit Scheme is an example of compulsory debt.

3. Productive and unproductive debts:

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. If the borrowed money is invested in the construction of railways, irrigation projects, power generations, etc. It adds to the productive capacity of the economy and also provides a continuous flow of income to the government. The interest and principal amount is generally paid out of income earned by the government from these projects. Unproductive are those which do not add to the productive capacity of the economy. Such debts are not necessarily self-liquidating. The interest and the principal amount may have to be paid from other sources of revenue, generally from taxation, and therefore, such debts are a burden on the community. Public debt used for war, famine relief, social services ,etc. is considered as unproductive debt.

3. **Short Term, Medium Term and Long-Term Debt:**

   Here the basis of classification is duration of loans. Short-term debt matures within a duration of 3 to 9 months. Generally, rate of interest is low. For instance, in India, Treasury Bills of 91 days and 182 days are examples of short term debts incurred to cover temporary shortages of funds. The treasury bills of government of India, which usually have a maturity period of 90 days, are the best examples of short-term loans. Interest rates are generally low on such loans. Long-term debt has a maturity period of ten years or more. Generally the rate of interest is high. Such loans are raised for development programmes and to meet other long0-term needs of public authorities. Medium-term debt has a maturity period in between short-term and long-term loans. The rate of interest is intermediate. They are generally raised for welfare programmes.

4. **Redeemable and Irredeemable Debt:**

   Redeemable debt is repaid at some specific future date and therefore, government has to make arrangement for repayment of interest and principle amount within a specific time period. These loans are terminable. The debts which the government promises to pay off at some future date are called redeemable debts. In case of irredeemable debt, no definite date for final repayment is promised for the rate of interest is paid regularly. Therefore, the government makes arrangements for interest payment only. Such debts are likely to become perpetual and therefore, they are considered as undesirable on the grounds of sound finance. The maturity period is not fixed. Such loans create a burden as taxes would be raised to pay the debt in the future.

5. **Funded and unfunded debts:**

   The basis of division is duration of the loan. It has a maturity period of at least twelve months at the time of issue. The period is generally longer than this and it may be even 30 years or more. Funded debt has an obligation to pay a fixed sum of interest, subject to an

option to the government to repay the principal. The government may repay it even before the maturity if market conditions are favourable. Unfunded debt has an obligation to pay at due date with interest. In such debts duration is comparatively short say a year. Unfunded debts are incurred to meet temporary needs of the government. The rate of interest is low.