



UNITED NATIONS
ECONOMIC
AND
SOCIAL COUNCIL



Distr.
GENERAL

E/CN.3/325
18 January 1965

ORIGINAL: ENGLISH

STATISTICAL COMMISSION
Thirteenth session
Item 16 (b) of the provisional agenda

A NOTE ON CLASSIFICATION OF PUBLIC DEBT TRANSACTIONS

(Report by the Secretary-General)

INTRODUCTION

1. At its twelfth session, the Statistical Commission emphasized the "importance of an economically meaningful classification of public debt transactions" and expressed a wish for the initiation of work in this field.^{1/} The present note seeks to provide a basis for the discussion of a framework for the classification of public debt transactions. It is not intended to set a standard or a model but simply to facilitate a discussion of this subject at the Statistical Commission and at the national level. In the preparation of this note account has been taken of the work done by the IMF in this field.

Scope and Definition

2. The scope of debt transactions to be considered for purposes of classification would necessarily depend on the scope of transactions in goods and services and transfers to which such debt transactions are directly related or with which they are integrated. Since borrowing is normally used to meet government deficits, it should be possible to relate the changes in the debt to the over-all cash deficit, taking into account changes in cash holdings, foreign grants received and gains or losses from monetary operations. In a consolidated statement of accounts for a given sector, e.g. central government sector, intra-governmental holdings of debt would, of course, have to be excluded in order to link the over-all surplus or deficit in such accounts to the net change in the total combined liabilities of the entire sector. Discrepancies between changes in the public debt and net borrowing

^{1/} E/3633, paragraphs 107 and 109.

could be reconciled in supplementary statements. In practice, therefore, the scope of debt transactions might vary from country to country, depending on the scope of its government budget.

3. In considering a possible scheme for the classification of public debt transactions it is therefore essential in the first place to determine the sector and the agencies comprising it so that the changes in their debt liabilities could be related to the over-all deficit in the transactions of these agencies. In its common usage, the term "public" is often synonymous with government and admits of as much wide import as the word government itself. The multitude of governmental agencies are characterized by the type of activity undertaken by each one of them, and, further, in terms of their individual relationship, financial and organizational, to the political centre of decision making. A distinction may be made between a government sector and a public sector.^{2/} Government sector comprises those agencies whose operation and finances are subject to detailed control of a common political body which constitutes the centre of decision making. These agencies would be normally engaged in a variety of activities such as general government, trading or financial. Independent public enterprises or bodies, whose finances may be separated and which may have more operational freedom, fall outside the government sector but together with agencies of the government sector they constitute the public sector. According to this distinction the government sector would include all organs of state, ministries or departments together with their "offshoots" such as Boards, Trusts, etc.; extrabudgetary funds and accounts, ancillary agencies and government enterprises; trading and financial. In this note only the classification of debt transactions of the government sector at the central government level is presented.

4. The distinction between the public and government sector and the use of the latter in this note does not, however, restrict the usefulness or the possibility of extended application of the classification scheme to other levels of government or to the wider concept of public sector. On the other hand it lends clarity to the analysis. The liabilities of any or all agencies - such as trust or extrabudgetary funds - falling within the government sector could be considered as liabilities of the government sector.

^{2/} The distinction made here is based on the Manual for Economic and Functional Classification of Government Transactions. United Nations, New York, 1958; for details, see Chapter III.

5. A debt is essentially a liability of a government but all financial liabilities do not necessarily constitute total debt of a government. The concept of total debt is slightly narrower in scope and excludes certain types of liabilities. The definition of debt adopted here assumes that transactions are recorded on a cash basis and excludes financial liabilities such as accounts payable, deferred charges and all contingent liabilities. It also excludes currency in circulation, debts of government deposit banks, obligations held by the issuing sector and "guaranteed obligations" of provincial or state governments, local authorities and of independent public enterprises or bodies because these fall outside the central government sector. Secondly, the debt is defined on a gross basis and not on a net basis. The gross concept is more relevant for purposes of economic analysis since it indicates the total financial claims of all other sectors on the government sector. In other words the contributions to the sinking funds or the amounts outstanding in such funds are not considered as diminishing the total debt liability until such amounts are actually used towards the redemption of debt. An illustrative statement on the definition of outstanding gross debt is given in Annex I.

6. Gross debt is further divided into national currency debt and foreign currency debt. The former is defined as debt which the government has option of redeeming in fixed amounts of domestic currency. Such loans are invariably subscribed in national currency and the service charge and the repayment of the principal is also expressed in national currency. Foreign currency debt is defined to include loans whose service charge and the principal is payable in foreign currency.

Cost of Debt

7. The cost of borrowing is determined, excluding considerations of a rise in the general price level, by the rate of interest paid and by the period over which it is paid. There may be cases where loans are floated at a discount so that there is a built-in element of capital appreciation which raises the cost of such borrowing to the government. For economic analysis, however, debt could be classified by the rates of interest paid and the maturity of debt. Interest rate

analysis and the liquidity pattern of debt are significant because they reflect the relative cost of borrowing in the money and capital markets and often affect the over-all structure of interest rates.

Maturity Distribution of Debt

8. Debt may be classified into three broad categories according to its maturity at the date of issue. In the first place, short-term debt would include obligations maturing within a year. Secondly, medium-term debt may be defined as one redeemable within one to five years from the date of issue. Thirdly, long-term debt may be considered as those obligations which have a maturity of more than five years. The spread in the last category could be, of course, very wide and it might include indefinite long-term obligations. For purposes of classification a detailed time-scale of maturity is more useful. The maturity distribution of the total outstanding gross debt is presented in Annex II. In this table, maturity of debt is considered in a given fiscal year and not at the date of issue. In other words, the maturity as shown here indicates the unexpired period of time before an obligation becomes due for redemption. This has the advantage of indicating not only the liquidity pattern of debt but also of pointing out the amount of debt maturing for redemption in any given fiscal year. A similar classification could also be applied to the total debt according to the maturity at the date of issue. Such a classification is presented in Annexes VII and VIII.

Interest Rate Structure

9. Interest rates are largely related to the availability of loanable funds and to the period over which they are required. A study of the structure of interest rates and of changes in them over time is facilitated by the classification presented in Annex III. In this table interest rates relating to only three broad categories of debt are shown viz. short-term, medium-term, and long-term. The rates indicated by these periods would reflect the time-preference schedules of the lenders. The interest rates shown would be average rates for each period. In practice there might be small differences among the actual rates charged and paid but such differences would be mostly negligible except perhaps in the case of long-term interest rates. There might be important differences here if the spread of maturities of long-term securities is very wide. In such cases either the concept of median may be used or the maximum and the minimum long-term rates may

be shown together with the average rate. The interest rates to be shown in Annex III would obviously indicate the nominal yield and relate to the gross fresh borrowing in any fiscal year. The effective yield may be higher or lower depending on the behaviour of government security prices in the capital market. Apart from the play of such market forces the effective yield would also depend on whether or not the interest income is exempt from the income tax. When such income is exempt from taxation the relative effective yield is often more than the one indicated by the interest rate. By taking into account the market prices of marketable debt a similar table could also be constructed showing the structure of effective yields.

Ownership of Debt

10. Ownership distribution of government debt is very significant and useful because it shows the liquidity preferences of investors in the economy. For purposes of classification, total gross debt as defined in Annex I may be taken. It includes both domestic and foreign debt which may be converted into national currency at official rates of exchange. A classification of debt by ownership is presented in Annex IV. This is based largely on the scheme followed by the IMF. The table distinguishes four broad sectors. Item 2 relates to the agencies within the central government sector and is more in the nature of a memorandum item. Items 4, 5 and 6 relate to the government sector at lower levels of political bodies and to the agencies outside the government sector but inside a public sector. In other words, the sum of Items 2, 4, 5 and 6 could be considered as debt held by the public sector agencies. Item 8 indicates debt held by foreigners and would largely correspond to the total amount of foreign currency debt. Item 9 represents total claims of the domestic private sector including the monetary system. The central bank is not included as a part of government sector in accordance with the treatment accorded to it in the Manual.^{3/} The amount of debt for each holder may be recorded at nominal or face value because debt transactions in government books are often recorded at face value. It is, however, likely that the creditors might record their holdings on the basis of market prices in their books.

^{3/} Op. cit.

Cross-classification by Ownership and Maturity

11. For any fiscal year a detailed spectrum of liquidity-cum-time preferences of investors could be obtained by a cross-classification of debt by ownership and maturity as shown in Annex V. For purposes of this classification only that total amount of debt is taken into account which is held outside the central government sector (i.e., Item 3 of Annex IV). The debt held within the central government sector itself is excluded. In Annex V the list of creditors from Annex IV is reproduced vertically and the categories of maturity are stated horizontally.

Reconciliation Between Net Borrowing and Changes in Gross Debt

12. The changes in gross debt outstanding are not always equal to the difference between new borrowing and repayment of debt in a given fiscal year. The discrepancy may arise due to various causes such as assumption or repudiation of debt, increased liabilities arising from accrued interest, changes in the valuation of foreign debt, etc. In Annex VI a table is provided to analyse and reconcile this discrepancy. The reconciliation is presented separately for domestic and foreign debt. Accrued interest is considered as debt when no cash payment is made for the interest liability and the amount of interest payable is treated as having been re-lent by the creditors to the government. For example, in the case of savings bonds or certificates with fixed-term maturity the accrued discount less interest paid on such instruments would be included in the principal of the debt. Differences between changes in nominal claims and proceeds from borrowing or outlays on redemption would arise when issues are floated either at a discount or a premium and when the Treasury itself, or through the central bank, buys its own securities in the market before the completion of their maturity at prices below or above their face value.

Effect of Financial Operations on Government Debt

13. The financial operations of the government have an effect on the debt transactions. If a budget is in balance, the net borrowing of agencies included in the budget would be zero. But a surplus^{4/} or a deficit in the budget would be reflected in the debt transactions. It should be noted that the change over a

^{4/} The assumption being that a surplus is utilized towards debt redemption.

40. Sales less purchases of negotiable short-term securities issued by the central government agencies.
41. Issues of securities in exchange of ownership rights.
42. Net increase in coins issued.
43. Net increase in pension liabilities.
44. Net increase in payables.

It may be noted that the sum of items 36 to 44 would constitute net increase in financial liabilities. According to the definition of debt adopted in this paper, the total net debt incurred would be the sum of items 36 to 41.

18. An important element of the Manual classification is the distinction made, for analytical purposes, among various types of debt such as direct or non-negotiable borrowing, negotiable or marketable debt and securities issued in exchange for ownership rights. Direct borrowing at home is classified by lenders viz. central bank, commercial banks, and private non-banking sector. Similarly, Item 39 is classified into domestic and foreign long-term debt. The Manual scheme suggests a possible classification of debt transactions and it can be used both in respect of annual net borrowing and gross debt outstanding. This is presented in Annex VII.

19. The Annexes II to VII are provided to analyse certain important characteristics of debt transactions. For a brief consolidated statement of the total outstanding debt a classification on the lines of the one presented in Annex VIII is suggested.

ANNEX I

Definition of outstanding gross debt - Central Government

Total Gross Debt = Floating debt, short-term debt, long-term debt, overdrafts and advances from central bank and other banks, assumption of debt and accrued interest, net increase in deposits with government savings banks, and issues in exchange of ownership rights.

= Total Liabilities of the Central Government

Less - Accounts payable, deferred charges, contingent liabilities, debts of government deposit banks, currency in circulation, guaranteed obligations, benefit liabilities for social insurance, employee pensions, dormant debt, obligations held by the issuing sector, etc.

Plus - Assumption of debt and accrued interest.

ANNEX II

Maturity^{1/} Distribution of Total Outstanding Gross Debt

Maturity at Fiscal Year Ending _____		Amount in Million _____							
		Date	Month						
End of Fiscal Year	Maturity in years	Less than 1 year	1 - 5	5 - 10	10 - 15	15 - 20	21 - 25	Over 25 years	Total
	1960	Domestic							
	Foreign								
1961	Domestic								
	Foreign								

^{1/} For the concept of maturity in this table, see para. 8.

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ANNEX III
Structure of Interest Rates

Average Percentage Nominal Interest Rates

Fiscal Year	Short-Term	Medium-Term	Long-Term
1960	2	3	4
1961	2	3 1/4	4 1/4

ANNEX IV

Ownership Distribution of Central Government Debt

<u>At Face Value</u>	In Million <u>national currency</u>		
	Fiscal Year Ending _____		
	Years	1960	1961
1. Total Gross Debt			
<u>Of Which Held By</u>			
2. <u>Central Government Sector Agencies*</u>			
(a) Social Insurance System ^{1/}			
(b) Trust Funds ^{1/}			
(c) Sinking Funds ^{1/}			
(d) Other Agencies			
3. <u>Debt held outside the Central Government Sector (Item 1-2)</u>			
<u>Of Which Held By</u>			
4. State or Provincial Governments			
5. Local Authorities ^{1/}			
6. Independent Public Enterprises or Bodies			
(a) Financial			
(b) Industrial			
(c) Other			
7. <u>Debt held by the Domestic Private Sector and by Foreigners (Item 3 - (4 + 5 + 6))</u>			
<u>Of Which Held By</u>			
8. <u>Foreigners^{1/}</u>			
(a) Foreign Governments			
(b) International Institutions			
(c) Non-Resident Banks			
(d) Non-Resident Business and Individuals			

* This item is called "Intra-governmental Accounts" in the IMF scheme.

^{1/} As shown under IMF scheme.

Annex IV (continued)	Years	1960	1961
9. <u>Debt held by the Domestic Private Sector (Item 7-3) Of Which</u>			
10. <u>Central Bank</u> ^{1/}			
(a) Securities			
(b) Overdrafts and Advances			
11. <u>Deposit Money Banks</u> ^{1/}			
(a) Securities			
(b) Overdrafts and Advances			
12. <u>Other Financial Institutions</u> ^{1/}			
(a) Savings Institutions			
(b) Insurance Companies			
(c) Other			
13. <u>Non-Financial Incorporated Enterprises</u> ^{2/}			
14. <u>Other Business</u> ^{2/}			
15. <u>Individuals</u> ^{2/}			
16. <u>Balance not Distributed</u>			

^{2/} In the IMF scheme these items are shown individually under "All others".

ANNEX V

Classification of Debt by Ownership and Maturity

Amount in Million _____

	Short-term Debt	Medium-term Debt	Long-term Debt	TOTAL
1. Total debt held outside the central government sector				
2. State or provincial governments				
3. Local authorities				
4. Independent Public Enterprises or bodies				
(a) Financial				
(b) Industrial				
(c) Other				
5. <u>Foreigners</u>				
(a) Foreign governments				
(b) International institutions				
(c) Non-resident banks				
(d) Non-resident business and individuals				
6. <u>Central Bank</u>				
7. <u>Deposit money banks</u>				
8. <u>Other financial institutions</u>				
9. <u>Non-financial institutions</u>				
10. <u>Other business</u>				
11. <u>Individuals</u>				
12. <u>Balance not distributed</u>				

ANNEX VI

Reconciliation Between Net Borrowing and Changes in
Gross Debt Outstanding

Amount in Million _____

DOMESTIC DEBT									FOREIGN DEBT																							
Year																																
(1)	Balance at End	(2)	Accrued Interest	(3)	Debt Assumption	(4)	Debt Repudiation (-)	(5)	Net Borrowing (+) or (-)	(6)	Differences between changes in nominal claims and proceeds from borrowing or outlays on redemption (+) or (-)	(7)	Other causes (+) or (-)	(8)	Balance at End	(9)	Balance at End	(10)	Accrued Interest	(11)	Debt Assumption	(12)	Debt Repudiation (-)	(13)	Net Borrowing (+) or (-)	(14)	Differences between changes in national claims and proceeds from borrowing or outlays on redemption (-) or (+) and Revaluation in terms of national currency	(15)	Other (+) or (-)	(16)	Balance at End	(17)

ANNEX VII

Classification of Outstanding Gross DebtFiscal Year Ending _____
Date Month

Amount in Million _____

Fiscal Year	DIRECT BORROWING					MARKETABLE SECURITIES					Issues in Exchange of Ownership Rights	Total Outstanding Debt
	Savings Bonds	OTHER DOMESTIC			Abroad	LONG-TERM			Short-term			
		Central Bank	Commer- cial Banks	Private Non- banking Sector		Domestic						
						Central Bank	Commer- cial Banks	Private Non- banking Sector		For- eign		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)

ANNEX VIII

Summary Consolidated Statement of Outstanding Debt -
Central Government

Fiscal Year Ending	Date	Month	Amount in Million	
	Fiscal Year		1960	1961

Description of Debt

1. Domestic
 - (i) Long-term
 - (ii) Short-term
2. Foreign Debt
 - (i) Long-term
 - (ii) Short-term
3. Total Debt = (1 + 2)
Of Which
 - (i) Intra-Governmental Accounts
 - (ii) Monetary System
 - (iii) Domestic private non-banking sector
 - (iv) Foreigners
