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The Burden of Public Debt

We shall devote this part of the unit to a discussion of the much controversial issue, namely, whether public debt imposes any burden on the community concerned or any portion there of, and also whether the burden, if any, of the public debt can be shifted to a subsequent generation, the burden of public debt public debt refers to the sacrifice it will impose and have effects on the community through a rise in taxation, necessitated at the time of repayment and for paying the annual interests on the government loans.

A distinction is made between financial burden or primary burden and real burden or secondary burden. When a debt is incurred by the government, the level of taxation in the economy has to be increased in order to meet the interest charges as long as the debt continues to exist. To the extent of the increase in tax level, the income of the people is transferred to the government. The consequent loss in the income of the people may be called financial burden of public debt.

The higher level of taxation caused by the rising public debt may have some repercussions on the economy in the form of adverse effects on the capacity and willingness to work and on the capacity and willingness to save. These effects may be called real burden or secondary burden of public debt.

There are various ways of estimating the burden of public debts. However, not only one method but the combination of various methods should be adopted. The relevant factors which should, therefore, be taken into account is considering as to whether an internally held public debt imposes a burden, and if so how much, are set forth below:

1) The nature of burden of an internally held public debt is different from that an externally held public debt. In the case of an externally held public debt the interest and the principal are required to be paid by the debtor countries to the creditor countries by means of export surplus and, as such, by the transfer of real resources from the debtor countries to the creditor countries, In the case of an internally held public debt, on the other hand, the resources remain within the country but only require to be transferred from the taxpayers to the bondholders in the from of interest payment to the latter.

2) If the burden of an internally held public debt is measured by the amount of interest transfer to be made annually from the tax payers to the bondholders, then it follows that the burden is not measured by the absolute amount of the public debt but by the rate of interest stipulated on the bonds. Thus the burden of a given amount of public debt is with, say, a 2% interest rate is half the burden of the same amount of debt with a 4% interest rate, since in the former case the required money transfer from the tax payers to the bondholders by the state is half that in the latter case.

3) If the burden of public debt consists in the raising of taxes for paying interest to the bondholders, then the burden is measured by the amount of the strains and frictions which are imposed on the economy as a result of the tax raising and interest payment programmes and the ultimate limit of the size of the public debt is determined by the strains and frictions which can be imposed upon the community in this manner, the bonds are held predominantly by the richer section and the tax is raised from the poorer people, them these strains and

frictions will be greater than if the bonds are held by the poorer people and the taxes are imposed on the richer.

4) Prof. Domar holds that the burden of public debt should be defined as the ratio of total debt to the total national income i.e. total debt /total national income. If the total amount of national income remains constant and the total amount of public debt increases year after year, the burden of the debt would increase. 5 Public Debt 6 But if the national income also rises, say, by a constant amount, then in spite of the increase in the volume of public debt, the burden of public debt, defined as the total amount of public debt divided by the total amount of national income, will actually fall, This will be more so if the national income rises by a constant relative amount along with the rise in the amount of public debt, in other words, as the national income rises the total amount of tax collected by the state rises automatically, and thus larger and larger amounts of public debt may actually impose lesser and lesser amount of burden.

5) The Domar argument that the burden of public debt (defined as the ratio of public debt to national income) may be reduced even with an increase in the absolute volume of public debt can e shown by means of the following simple example. Let us conceive of three cases, namely, case I where national income remains constant over years; cases II where national income increases over years; and case III where national income rises at a faster rate than in case II. Suppose also that in all the cases 20% of national income is debt financed and that a given amount of national income obtained by deficit financing in a particular year lasts for that year only and hence to generate the same amount of income during the next year an additional amount of deficit financing and hence public debt creation will be necessary.

Case I (when national income is constant at, say, Rs. 500).

	Year I	Year II	Year III	At the end of the third year
Public debt/National income=	100/500	100/500	100/500	300/500(>1/2)

Case II (when national income increases by, Rs. 100 per annum).

	Year I	Year II	Year III	At the end of the third year
Public debt/National income=	100/500	120/600	140/700	360/700 (=1/2 approx)

Case III (when national income increases by, Rs. 200 per annum).

	Year I	Year II	Year III	At the end of the third year
Public debt/National income=	100/500	140/700	180/900	420/900(<1/2)

From the above table it appears that though the absolute amount of the debt increases from case I to case II to case III from Rs.420 each at the end of the third year, the burden of debt (defined as the ratio of public debt to national income) decreases from greater than half to half and to less than half in the cases in that order. Domar has further shown that if the national income increases by a constant relative rate the ratio will after sometime become constant and will not vary at al whatever be the volume of the debt (and national income).

6) Dr. Lerner is of the opinion that when unemployment is fought by deficit spending and as such the amount of public debt increases, the so called burden of the debt should be weighed against the burden of unemployment which would be there if the deficit spending programme had not been undertaken. And if this is done, the burden of the debt may appear to be much smaller and even nil or negative.

7) A large amount of public debt requires a correspondingly large amount of tax collection and this may adversely affect work incentives saving and risk taking propensities, which under certain circumstances, may mean a worse allocation of economic resources.

8) It is sometimes held that a large amount of public debt increases the inequality of income distribution in favour of the bondholders since the bondholders are generally the richer people whereas there is definite limit up to which taxes may be made progressive without serious detrimental effect on work incentives etc. this point of view has, however, been contested by Dr. Lerner who holds that it is because of the inequality of income distribution that public debt is held by the richer section in large quantities. In other words, the inequality of income distribution is the cause, not the effect, of the concentration of public debt in the hands of the richer few.