**M.Phil. (Economics) Semester II**

**ECO-124**

**(Environmental Economics and Public Economics)**

**Topic: Burden of Public Debt**

**LECTURE NOTE I**

**Public Debt**

Local, state and federal governments all borrow money to pay for large projects, such as new government buildings, schools or for funding etc. This forms what is collectively known as the public debt, so- called because it is money that public organizations owe for which the burden of paying rests ultimately with taxpayers. This debt can take the form of many types of loans to the government. Public debt may be raised internally or externally.

### Burden of Internal Debt:

It is said that an internal debt has no direct money burden since the interest payment on debt and the imposition of taxation to pay interest to the lenders is simply a transfer of purchasing power from one to another. This means that in case of internal debt, money is borrowed from individuals and institutions within the country.

Repayment (raised from taxation) constitutes just a transfer of resources from one group of persons to another. In other words, these are transfer payments and do not affect the total resources of the community Truly speaking, govern­ment collects money through taxation imposed on the richer people who are also the buyers of government bonds.

That is to say, government collects money from the left pocket and pays it back to the right pocket. Thus, under internal debt, since all payments cancel out each other in the community as a whole, **there is no direct money burden.**

Above all, money collected from internal source of borrowing is usually spent for various developmental activities. Such expenditure results in transfer of resources in the community and, as a result, aggregate resources of the country increase. Thus, there can be no direct money burden of internal debt.

But there is no denying the fact that **internal debt involves direct real burden to the community** according to the nature of the series of transfer of incomes from taxpayers to the creditors. If we assume that the taxpayers and bondholders are the same persons then there can be no direct real burden of debt. But we know that the taxpayers and the bondholders belong to different income groups in the community.

Usually, the bondholders are richer people compared to the taxpayers.

Certainly, it is necessary to raise taxation to pay interest on the debt and, the greater the debt, greater the amount of taxation required to provide the interest on it. Ordinarily, taxpayers are poor people. When the government pays interest with principal to the bondholders, it results in the transfer of purchasing power from the poor people to the richer people.

Thus, the payment of internal debt involves redistribution of aggregate income. This results in inequalities in the distribution of income and wealth. This is the direct real burden of debt on the community.

Again, it is argued that taxpayers are generally active people while bondholders are idle, old and inactive ones who live on accumulated wealth. In case of repayment of internal debt, wealth thus gets transferred from the active persons, i.e., taxpayers, to the inactive persons, i.e., bondholders. This certainly adds to the real burden of debt.