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THE BURDEN OF DEBT

Abba P. Lerner

"But look," the Rabbi's wife remonstrated, "when one party to the dispute presented their case to you you said 'you are quite right' and then when the other party presented their case you again said 'you are quite right,' surely they cannot both be right?" To which the Rabbi answered, "My dear, you are quite right!"

MESSRS. Bowen, Davis, and Kopf have shown¹ that the real burden of a project using up resources in the present can be shifted to future generations by internal borrowing, providing one defines "generation" in a particular way. It is just as easy to prove that all politicians are economists or that all economists are dunces, provided one defines "economist" in a particular way. But even if I call the tail of a sheep a leg that will not turn sheep into quintapeds. The issue is of course terminological rather than substantive. It is nevertheless one of the utmost importance because the conclusion reached by Bowen *et al.*, although not incorrect on their own definitions, is bound to be misinterpreted as meaning what it seems to be saying in English and as indeed implying that most politicians understand economics better than the economists — most, if not all, of whom are dunces.

Bowen, Davis, and Kopf are absolutely right when they agree that there is "absolutely nothing" wrong with the standard argument of modern economists that the real burden of a debt can *not* be shifted to future generations if it is defined as "the total amount of private consumption goods given up by the community *at the moment of time the borrowed funds are spent.*" But President Eisenhower "appears convinced that the costs of debt-financed public projects can be passed on to future generations." Like the Rabbi in the story, Bowen *et al.* want to say that he too is right, but in their enthusiasm they even say that the purpose of their note "is to suggest that in this instance it is the President who is — in at least one highly important sense — right,"²

¹ W. G. Bowen, R. G. Davis, and D. H. Kopf, "The Public Debt: A Burden on Future Generations?" *American Economic Review*, L (September 1960), 701-706.

² *Ibid.*, 701, where President Eisenhower is quoted as saying, "Personally, I do not feel that any amount can be prop-

thus clearly implying that the economists are wrong.

To make the President appear right, Bowen *et al.* redefine "present generation" to mean the people who lend the money to finance the project, and they redefine "future generation" to mean the people who pay the taxes that are used to repay the principal and the interest on the loans. The perversity of the redefinitions is obscured by supposing that the lenders ("this generation"), are all 21 years old at the time of the execution of the project when they lend the money and by supposing that they are repaid 44 years later, on their 65th birthday, with funds obtained at that time from 21-year-old taxpayers ("the next generation"). The burden is thereby shifted from "this generation" to "the next generation."

What has been proved, if we obstinately insist in expressing the conclusion in English, is that it is possible to shift the burden from the Lenders to the Taxpayers or, we might say, from the Lowells to the Thomases. The Lowells are better off and the Thomases are worse off than if the Lowells had been taxed to raise the money for the project in the first place.

The "red herring" nature of having the Lowells lend the money now (so that we can call them the present generation) and having the Thomases pay the taxes in the future (so that they can be called the future generation) jumps to the eye if we note that the shifting of the real burden of the project from the Lowells to the Thomases (or indeed of any other burden) could take place just as well at the time of the project (or at any other time) by simply taxing the Thomases instead of the Lowells.

No economist, so far as I am aware, has ever denied the possibility of borrowing or of lending or of taxing some people instead of others, or of any combinations of such oper-

erly called a surplus as long as the nation is in debt. I prefer to think of such an item as a reduction on our children's inherited mortgage," in his *State of the Union Message*, January 7, 1960.

ations. And if we redefine Mr. Eisenhower's words so that they mean only that such operations are possible, then indeed the words used by the President constitute a true statement. But there is no reason for supposing that the President was trying to use any language other than English, and what the President said is simply wrong (in English), unless indeed all the economists (including Bowen *et al.*, as well as J. M. Buchanan, who plays similar linguistic tricks³) are absolutely wrong.

The real issue, and it is an important one, between the economists and Mr. Eisenhower is not whether it is possible to shift a burden (either in the present or in the future) from some people to other people, but whether it is possible *by internal borrowing* to shift a real burden from the present generation, in the sense of the present economy as a whole, onto a future generation, in the sense of the future economy as a whole. What is important for economists is to teach the President that the latter is impossible because a project that uses up resources needs the resources *at the time that it uses them up*, and not before or after.

This basic proposition is true of all projects that use up resources. The question is traditionally posed in terms of the burden of a *public* project financed by *privately* held internal debt; but the proposition is quite independent of whether the project is public or private as well as of whether the debt is private or public. The proposition holds as long as the project is financed *internally*, so that there are no outsiders to take over the current burden by providing the resources and to hand back the burden in the future by asking for the return of the resources.

It is necessary for economists to keep repeating this basic proposition because one of their main duties is to keep warning people against the fallacy of composition. To anyone who sees only a part of the economy it does seem possible to borrow from the future because he tends to assume that what is true of the part is true of the whole. It is possible for the Lowells to borrow from the Thomases, and what this borrowing does is to shift a burden from the Lowells to the Thomases in the present,

and then to shift an equal burden from the Thomases to the Lowells in the future when the loan is repaid. To the Lowells (and to anyone else who sees only the Lowells) the combination of these two shifts looks like the shifting of a burden from the present into the future or the shifting of resources from the future into the present. To the Thomases, of course, the transactions will look like the opposite, namely, the shifting of a burden from the future into the present or the shifting of resources from the present into the future. But the borrowing and the repayment do not make a Time Machine. There is no shift of resources or of burdens between different points in time. It is possible for a *part* of the economy (the Lowells) to shift *its* burden into the future only as long as *another part* of the present economy (the Thomases) is ready to take it over for the intervening period. It is not possible for *the whole* of the present generation to shift a burden into the future because there are no Thomases left to play the magician's assistant in the illusion.

This is not to say that there is no way at all in which the present generation can shift a burden onto future generations. Our proposition is only that this is not done by internal borrowing. We can impoverish the future by cutting down on our investment in capital resources (or by using up or destroying natural resources) that would have enabled future generations to produce and enjoy higher standards of living. There is even a possible connection between internal debt financing and this way of really impoverishing future generations. If full employment (or some other level of employment) is somehow being maintained, and if the conditions of the borrowing and the kinds of people from whom the borrowing is done are such that they reduce consumption by less than consumption would have been reduced if the money had been raised instead by taxes, then there will be more consumption and there will therefore have to be less investment. The borrowing will then have reduced the real resources inherited by future generations.

But there is no *necessary* connection. It would almost certainly not work this way in the conditions of 1960. Whether the borrow-

³ In his *Public Principles of Public Debt* (Homewood, Illinois, 1958).

ing increases or decreases consumption depends on the nature and on the conditions of the borrowing on the one hand and of the alternative — the taxation — on the other hand. Furthermore, at the present time, when we have considerable unemployment and unused capacity, an increase in consumption is more likely to lead to *more* investment (out of unutilized resources) and therefore to an *increase* in the productive resources inherited by future generations. And it is quite certainly not these complicated considerations that are responsible for the President's belief that internal borrowing increases and repayment reduces "our children's inherited mortgage." In any case even the *possibility* of a genuine impoverishment of future generations by an induced reduction in investment is *explicitly* ruled out by Bowen *et al.* when they say that the resources consumed by the project "*must* entail a contemporaneous reduction in private consumption."⁴

Any genuine impoverishment of future generations must be the result of *not* reducing private consumption by the full amount of the resources used up in the project so that some of these resources must come out of alternative investment (if we rule out the use of unemployed resources). It is only the curtailed alternative investment outside of the project that can tend to impoverish future generations (although this might be more than made up for them by the benefits that these same future generations will derive from the project in question).

We can also impoverish the future by using up in the production of armaments too much of the resources that would have gone into investment; and we can equally impoverish the future by an over-economy in armaments, or by skimping in our contribution to the building of a healthy world, so that we invite aggression or foster resentments and revolutions.

⁴ *Ibid.*, 703, my italics.

But both of these possibilities are completely independent of whether we borrow or tax.

Semantic playfulness like that of Bowen *et al.* seriously sabotages economists in their important task in educating the public to the appreciation of an important truth. By their ingenious redefinition of "generations" they have made it more difficult to point out just where the fallacy of composition is perpetrated. It is perpetrated when a part of the economy (as in their definition of this or that generation) is taken for the whole (as in the usual meaning of a generation as *all* the people living at a certain date); and this is exactly what Bowen *et al.* do when they say that President Eisenhower (speaking English) is right.

They have taken a true proposition — i.e., that some people can shift a burden into the future by borrowing from other people — and rewritten it in such a manner that almost everyone will read in it the false proposition that the nation as a whole can filch resources from the future by internal borrowing (public or private), thereby impoverishing future generations. It is unfortunately the false proposition that is implied in the statement by the President, and believed by many people in positions to make vital decisions. The false belief may well contribute to a failure of the free nations to take the steps necessary to maintain and extend freedom in the world. There is even a clear and present danger that because of a baseless fear of impoverishing future generations by leaving them with a larger internal debt (which they will owe to themselves), we may fail to protect them from nuclear war and/or totalitarian domination; the confusion sown by Bowen *et al.* tends to increase that danger. It is to be hoped that these authors will tell the President that they were using a special language of their own and didn't mean what they seemed to be saying when they seemed to be denying a proposition with which, as they themselves declare, there is "absolutely nothing" wrong.