Public debt

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Public debt is one of the three primordial problems in political economy. (The others have been international trade vs protection, and taxation.) Debt has been a contentious issue since before capitalist economies developed with political and philosophical argument centring on not only the level of debt but the risk of unwise investment (squandering) of the borrowed funds and the risk of arbitrary repudiation of debts (for example, formerly, by sovereigns themselves).

Contemporary controversy is frequently fuelled by misperceptions about the level of debt. Currently Australia has comparatively low levels of public debt (36 percent of GDP compared with the OECD average of over 100 percent). This way of representing the situation may itself be misleading, as the 'burden' of debt depends more on whether the debt is being used effectively – to provide infrastructure that will yield benefits into the future and for which future generations can reasonably be expected to pay – and on the current strength of the economy (its capacity to meet repayment expectations). Short-term debt is in principle defensible for counter-cyclical and economic management purposes; however, as Keynes noted, it is more prudent to build usable, durable assets rather than to 'dig holes' and fill them in again – though such 'fortuitous and often wasteful mitigations' would still provide a fillip to economic activity. There are few societies that cannot benefit from debt-funded provision of sensible assets sooner rather than later. Still, liberals appear to resist the possibilities offered by debt, just as they resist public revenue raising – and for similarly insubstantial reasons.

Historically, our public debt was about 70 percent of GDP in the later parts of the nineteenth century, about 40 percent of GDP in the prewar decades, about 100 percent at the end of the war, and generally below 20 percent since the 1960s.[1] The current increase to 36 percent reflects the Rudd-government's stimulus spending in response to the global financial crisis. According to keynesian principles, debt can be incurred during times of downturn or crisis, with the presumption that it will be repaid when 'good times' return, so that the public budget is balanced over the cycle (perhaps thirty years) rather than each year. Theoretically, however, debt need never be repaid, provided a government adjudges the anticipated societal returns from present investments that cannot be easily funded otherwise will exceed the servicing charges. So the crucial determinant ought to be the need for and quality of the spending, not its level.

Public debt should not be snidely equated with 'living beyond one's means', even if that phrase had serious meaning for a nation. Public debt can allow a nation to expand its productive capacities, provided resources exist and are not being satisfactorily deployed. The social democratic (and keynesian) rationale for public debt therefore relies largely on the observation that privately funded activity is normally insufficient for full utilization of resources (particularly the workforce) and that continued reliance on private funding routinely results in under-investment and underdevelopment.

Arguably, Australia's public debt is currently too low – public infrastructure could be improved if we called on the rest of the world's financial resources and lifted borrowings to about New Zealand's level (that is, to 42 percent of GDP), or doubled the current figure (to 72 percent of GDP, a level which would still leave us in the lower half of the OECD league). The first scenario would give us about $100bn extra each year and the second about an additional $600bn. ($600bn also approximates the treasury's estimate of Australia's infrastructure deficit.)

The rationale for politically motivated debt to develop or restructure industry has a long provenance – going back to the theorists of the Italian city states (Giovanni Botera and Antonio Serra in 1588 and 1613 respectively).[2] This renaissance tradition in economic thought insisted that good infrastructure, good governance, good architecture, good science, good philosophy, good education, good health, even good art and music, could be provided by the state *in advance of* *economic development* to lure merchants and traders and thence assure prosperity and 'magnificence'.

The most complete modern development of these principles is in the German historical school of economic thinkers, some of whom were conservative nationalists, together with statists, institutionalists, weberians and sociological writers on economic matters. In the twentieth century, mercantilist ideas were adapted to critique the presumption, especially among anglophone writers, that private capital needed to pre-exist private (or public) investment and that spontaneous development could reliably ensure or steer the wealth of nations.[3] In other words, liberal faith in self-interest and individual custodianship of economic activity was always an unwarranted denial that politics, or distinctive public-finance principles, could usher in productivity-enhancing foundational conditions. These more expansive political ambitions often, even typically, depend on funding through debt, underwritten or guaranteed by government. They require not so much that the rest of the world forgoes its own activity in favour of current activity here, as a willingness and ability to calculate that present costs can be more than compensated by future gains. Present benefits of debt-funding, especially when it promotes more or better activity, can outweigh the costs of the debt, even if debt becomes permanent. A chronic problem in market economies is that the resources available for solving needs are frequently not so deployed. Obviously these estimations require a reasonable level of bureaucratic competence, usually embodied in permanent public institutions.

The above argument implies that the use of debt for funding public projects is an alternative to taxation – the advantage of the latter being that it transfers resources from the private to the public realm, and probably from consumption to investment; while the advantage of debt is that it calls on future generations to largely bear the cost of infrastructure commitments made now.

The keynesian rationale for debt has often been expressed in terms of the requirements of economic management, particularly to achieve full employment, however at root is the recurrent likelihood of deficient investment. Counter-cyclical investment policy therefore rests on an acknowledgement that the rise and fall of industry ought not be left to market processes – where the destructive elements in 'creative destruction' can obviate the creative ones, at least in specific locations. The capacity-augmenting effects of infrastructure spending are almost always more important than its income-generating effects. In these circumstances, benefit-cost calculations (or 'business plans') are less pertinent to the political judgement than considerations thrown up by technological opportunity.

The need to facilitate economic transformation (that is, to encourage structural change), though sometimes resisted, will be an enduring one – as will the political problems associated with it. To this end, debt-financing of transport and communication infrastructure, as well as of education, training and environmental protections, which all enhance production and productive capacities, cannot be excluded or disparaged. In an uncertain world, judicious levels of debt can nurture not only prosperity and sustainability, but also civility.

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[1] Current figures are from *OECD Economic Outlook* no.93, May 2013; historical figures are from 'A history of public debt in Australia' Katrina Di Marco, Mitchell Pirie & Wilson Au-Yeung, Australian Treasury, 2011.

[2] Giovanni Botero. 1588. *On the causes of the greatness and magnificence of cities* (trans Geoffrey Symcox). Toronto: University of Toronto Press, 2012; Antonio Serra. 1613. *A short treatise on the wealth and poverty of nations* (trans Jonathan Hunt). London: Anthem Press, 2011. The more general argument for industry *policy* is in Erik S Reinert. 2007. *How rich countries got rich … and why poor countries stay poor*. London: Constable, chs 7 & 8.

[3] Carl-Ludwig Holtfrerich. 2014. 'Public debt in post-1850 German economic thought vis-à-vis the pre-1850 British classical school' *German Economic Review* vol.15(1), February, pp.62-83.