

## Indebted State versus Intermediary State: Who Owes What to Whom?

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### Abstract

Ratios of public debt to GDP are much discussed these days and questions concerning debt relative to taxation have long been explored by fiscal scholars. With respect to monarchical regimes, it seems reasonable to treat public debt as similar to personal debt, recognizing that a monarch is not an ordinary person. When public debt arises through parliamentary assemblies, however, the similarity of form between public and personal debt vanishes because a parliamentary assembly does not trade on its own account; to the contrary, it is a type of intermediary that brings together people who buy bonds and people who later pay the bondholders. In a republic there is no sovereign who is indebted to ruled subjects. The institutional framework of republican governance transforms public borrowing into a process of intermediation among citizens, which leads in turn to the alternative orientation toward public debt that this paper explores.

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## **Indebted State versus Intermediary State: Who Owes What to Whom?**

In their history of taxing and spending in the western world, Carolyn Webber and Aaron Wildavsky (1986) note that monarchs were continually turning to prominent and wealthy subject to secure loans to finance their activities. That loans were forthcoming was doubtlessly often a reflection of duress and not genuine contract, for sovereigns were difficult to deny. While sovereigns understandably would typically want to maintain credibility with their wealthy subjects, sovereigns also had tools of compulsion to compensate for erosion of credit worthiness that their prior activities might have created (Eaton and Gersovitz 1981) (Grossman and Van Huyck 1988). Regardless of the mixture of duress and contract in the supply of loans to monarchs, public debt could be theorized about as a particular type of personal debt, recognizing that a sovereign could not reasonably be reduced to a representative citizen.

In contemporary times, however, public debt arises mostly through the actions of parliamentary assemblies. Despite the institutional cleavage between monarchical and republican regimes, contemporary theorizing about public debt follows a mode of theorizing that is grounded in presumptions that are suitable only to monarchical regimes. A monarch can become indebted; a republic cannot. The term public debt can be applied to both types of regime, but this application will be misleading unless the differences between the two forms of regime are understood clearly. A parliamentary assembly is not an indebted monarch but rather is a type of intermediary that brings together, never wholly

voluntarily, people who buy bonds and people who at a later time pay off the bondholders. While a monarch's indebtedness is offset by the claims on him held by his lending subjects, in a republic there is no sovereign who is indebted to ruled subjects. Yet, it should be noted that some semantic ambiguities remain even in the Constitutional Charters of many republican monocentric systems such as Italy. The expression "head of state" is a glaring example of what we are saying. Head of state conjures an image in our minds that there exists a separate hierarchical structure independent of the citizens/taxpayers with whom he might run into debt, at least with some of them.

As we shall see further below, when we refer to De Viti's monopolistic state, the head of state has the further ambiguity of also meaning monopoly, which seems entirely inappropriate and which mimics the organismic theory of the state (Buchanan 1949). Even recognizing the institutional ambiguities, either implicit or explicit in many republics.

Ratios of public debt to GDP take on different significance in republican and democratic regimes than they do in monarchical regimes. In monarchical regimes those ratios provide information pertinent to the credit worthiness of monarchs, just as similar financial information provides pertinent information about the credit worthiness of individuals (Bulow and Rogoff 1989) (Calvo 1988). For republican regimes, however, there is no person who acquires liability for incurring and amortizing debt. The members of a parliamentary assembly vote to incur public debt but they do not assume liability for repayment of debt. A parliamentary assembly is only an intermediary that brings together the two sides

of a debt transaction. On the one side is the subset of citizens who buy the bonds; on the other side are the taxpayers of the future who will be liable for amortization of the debt. Within this institutional setting, ratios of debt to GDP speak, to the extent they speak at all, to the sustainability of a particular constitutional nexus of governance. A republican regime whose legislative assembly issues public debt that does not find buyers, or can find buyers only at the expense of generating widespread hostility and anger among taxpayers, is a regime that is undergoing a crisis of governance in that the very foundation of the constitution of governance has been allowed to erode. A crisis in public debt is a challenge to the constitutional nexus of governance and to all who occupy central positions within that nexus<sup>1</sup>.

While the gulf between monarchical debt and republican debt has been ignored by most fiscal theorists who speak of sovereign debt in generic terms, there are some notable exceptions who offered relevant insights for taking a different tack toward the analysis of public debt. One was Knut Wicksell (1896), who lamented that theorizing in public finance retained its originating presumption that fiscal phenomena arose from the choices of rulers who, by virtue of being rulers, stood apart from the subjects they ruled. While this presumption fit the institutional framework of absolutist regimes, it did not fit the

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<sup>1</sup> The expression head of state would make us think that the President of the Republic plays a leading role in the polity, in actuality his role is slim. It is the Parliament that plays that role, although in the nuanced form of intermediary between taxpayers and subscribers of government bonds. There is every reason for referring to the Parliament as an intermediary between the various members of the community and their different interests and not as representing the society.

institutional framework of republican regimes that had been emerging in Europe. Another such scholar was Antonio De Viti de Marco (1936), who expressly recognized that in republican regimes the state provided an intermediary function that brought together citizens with different interests and capacities. A monarch's indebtedness derives from transactions with creditors. For a republic, however, there is no sovereign who is indebted to ruled subjects. The institutional framework of republican governance transforms public borrowing into a process of intermediation among citizens, which leads in turn to the alternative orientation toward public debt that this paper explores. A third such scholar is James Buchanan (1958), whose approach to fiscal scholarship was heavily influenced by Wicksell and De Viti and other Italians, and who recognized explicitly that public debt could not reasonably be analyzed without piercing the veil of the state as a unified entity.

In this paper we first review the treatment of public debt as the debt of a ruling entity, under which public debt is regarded as potentially self-amortizing through appropriate sovereign actions. The remainder of the paper examines public debt within the alternative institutional framework of an intermediary republic. As should be expected, the analytics in this case differ depending on particular institutional details by which republics are constituted, as De Viti recognized through his distinction between cooperative and monopolistic republics. Regardless of whether the state is treated as cooperative or monopolistic, the state is a type of intermediary. Within the cooperative framework, the state organizes activities of positive value to all. Within the

monopolistic framework, by contrast, the state uses its powers of intermediation to give advantage to some people at the expense of others. In either case, however, the republican state is constituted as a nexus of people along with constitutional relationships within which governance proceeds, and most certainly is not a sentient being who acts and chooses.

A Louis XIV might exclaim that “the state is me,” and his exuberance in offering this exclamation would surely be understandable. In republican and democratic states, however, there is no one in a position to make such an exclamation. To be sure, within republican regimes of the monopolistic type there can be particular sets of people who are able to recognize that they have been able to use the offices of state to secure advantages for themselves by restricting the options available to other members of the polity. For republican polities, public debt is bound up with questions of who owes what to whom. The standard discussions of Ricardian equivalence evade addressing this question by effectively reducing republican polities to monarchies. Within republican regimes, moreover, public debt can undermine rule-of-law principles by promoting what can only be described as a systemic form of lying. To be sure, it’s not that there is some particular person who lies but that there is a constitutional nexus of governance that promotes such institutionally-grounded lying.

### **1. Sovereign Debt as Personal Debt: the Intermediary State**

For over three decades, most European governments, with Italy being in the forefront, have used deficit finance and the accumulation of public debt as an

ordinary means of financing their activities. This prevalent practice runs contrary to traditional notions of sound public finance, where taxation was the normal means of public finance and deficits were instruments only of extraordinary or emergency public finance. Even when there are constitutional limits on budget deficits and public debt, as is the case with Italy, those limits are routinely circumvented as Eusepi (2006) explains.

Efforts to place constitutional limits on public budgeting have always faced institutional resistance based on the desires of elected politicians to spend beyond the limits set by tax revenues, as Buchanan and Wagner (1977) explain. The dominant Keynesian theory contributed to this political proclivity by creating an ideological framework whereby the requirements of good governance appeared sometimes to require budget deficits, regardless of what principles of sound finance or constitutional limits on deficits might require. The Maastricht provisions set limits to budget deficits and public debt for EU nations, with budget deficits limited to 3 percent of GDP and public debt limited to 60 percent. Needless to say, Maastricht has been a failure as a fiscal constitution as these limits have been routinely ignored among EU nations. Despite this obvious failure, it is possible that the Maastricht provisions have reduced the aggregate of debt and deficits among the entirety of EU nations from what they would otherwise have been.

One thing that should be kept in mind is that budgetary figures are objects of political construction and not unavoidable facts of nature. Different budgetary pictures can be created from the same set of governmental activities, which

makes the idea of truth in the presentation of budgetary data an elusive notion. In a related context, for instance, Fritz Machlup (1964: 140-66) examined the US balance of payments for different years during the 1950s. During that period several changes were made in how various transactions were classified. Hence the same set of transactions can give different impressions of the balance of payments, due to nothing more than changes in accounting conventions. For instance, the balance of payments showed a surplus of \$5 billion in 1951 when the accounting conventions of that year were used. But when those very same transactions were examined by using the accounting conventions of 1959, there was a deficit of \$1 billion. Machlup performed the same exercise for other years and definitions, all to the same effect: the condition of a balance of payments is not some kind of natural phenomenon like the height of a redwood tree but is an artifact of human construction. Looking at the same set of transactions, one observer could declare that there is a deficit in the balance of payments while another observer could declare that there was a surplus.

Government budgeting is open to the same ability to paint divergent portraits from the same set of transactions and activities. Furthermore, the creation of budget limits will surely create political incentives to change the portrait, thereby making it appear that the limit was respected even if it wasn't. For instance, a deficit can be converted into a surplus by distinguishing between current and capital budgets. It is easy to think that capital budgeting would be a tool for promoting fiscal responsibility. The central claim advanced on behalf of capital budgeting is that the current budget would be balanced and financed by

taxation while the capital budget would be financed by debt, with only maintenance and depreciation appearing in the current budget. This procedure would resemble a good deal of commercial practice, except that the members of a parliamentary assembly are not like the members of a corporate board any more than those members are like a monarch.

As a hypothetical illustration of the point, suppose that a government that is constrained by a balanced budget requirement decides that it would like to sponsor a week-long retreat at Lake Garda for bureau chiefs. Under the balanced budget requirement, it could only support the program by cutting back on other programs by an equivalent amount. The presence of a capital budget would allow the government to escape this limit. All that would be necessary would be for it to declare the sojourn at Lake Garda to be a capital and not a current expenditure. It would be easy enough to do this. All that would be necessary would be to have a consultant write a memo explaining how the retreat would promote more effective bureau functioning in forthcoming years, thus representing a self-amortizing form of capital spending.

Alternatively and to equivalent effect, budgetary transactions can be moved to off-budget entities. In the US, for instance, the officially recognized public debt of the federal government is about \$14 trillion. This amount is dwarfed by what are described as unfunded liabilities, which are liabilities that do not appear as any budgetary entry but which are governmental promises and commitments all the same. Many of these liabilities arise through social security and Medicare, which have been estimated to be as much as \$100 trillion. There

are numerous other entities and transactions that also are removed from direct budgetary appearance.

Regardless of the range of gimmicks that might be employed in the presence of constitutional limits on public budgeting, the very presence of such limits illustrates our thesis that fiscal theorizing still presumes its phenomena to arise within a despotic institutional framework in that public debt is assimilated to personal debt. The Maastricht provisions call to mind a setting where a potential borrower is being examined by a potential lender. The lender is concerned about being repaid, so examines the potential of the borrower to amortize the debt. The Maastricht ratios speak to such prudential concerns. The literature on sovereign debt places great significance on the sovereign's reputation for repayment. The treatment of sovereign debt proceeds in the same analytical vein as the treatment of personal debt, save only that reputational matters are more significant for sovereign debt because legal remedies are not available to creditors of the sovereign, in contrast to the creditors of personal borrowers.

This conventional treatment of public debt treats a government as a form of business corporation. The models used and analytical language employed makes no effective distinction between public debt and corporate debt. Yet there is a difference, a huge one. With corporate debt, there are corporate owners who are indebted to other members of the society who are not owners of the corporation. The owners of a corporation are personally liable for corporate indebtedness up to the limit of the value of their ownership shares. The debt of a monarch is similar to that of a corporation. This is not the case, however, for the

members of a parliamentary assembly. Those members, in supporting creation of public debt, do not incur liabilities on their personal accounts. To examine public debt within republican regimes requires that we recognize that parliamentary assemblies are intermediary organizations similar to banks: where banks intermediate between depositors and borrowers, parliamentary assemblies intermediate among future taxpayers, current lenders, and beneficiaries of deficit-financed expenditure.

## **2. Republican Debt: Who Owes What to Whom?**

From a starting position of a balanced budget, suppose a parliamentary assembly decides to appropriate an additional \$100 billion. It can do this either by raising taxes or by borrowing. To keep the point simple, suppose all borrowing will come from within the national unit. If borrowing is selected, the government will have incurred a public debt of \$100 billion. If the government were a monarchy, it would be easy and correct to describe the monarch as indebted to those who supplied the funds by buying the bonds. It would be equally easy to describe the republic as indebted, but it would be wrong to do so because a republic is not an entity that is indebted to some other entity. Instead, it is just an intermediary that brings together, often with duress, the various parties that jointly constitute the transactional web that is republican debt.

With republican debt, a parliamentary assembly is an intermediary that connects members of the society in transactional webs that must be examined carefully to understand public debt in republican and democratic regimes. Public

debt takes on a different character once it is recognized that the state operates as an intermediary between borrowers and lenders. According to the vision of the cooperative state, the intermediary activities of the state would have similar properties to what would have emerged under a set of individual credit transactions. The state would operate as if it were a large finance company. The state itself would not be indebted. Nor would there be any reason for concern about the size of the state's intermediary activities. The extent to which credit transactions arise in place of tax financing would be an emergent product of societal interaction, as are all market transactions. Public debt would represent, as it were, a credit market inside the state. Within this market, taxes to amortize debt would be reflections of voluntary commitments made at an earlier time when those taxpayers chose to borrow rather than make tax payments.

In this manner, public debt as commonly portrayed would be a veil that concealed the nexus of credit transactions that constituted the public debt. Our analysis is a call for piercing the veil of public debt to reveal its transactional structure. This piercing exercise, however, can reveal different transactional structures, corresponding in significant measure to De Viti's distinction between cooperative and monopolistic states, keeping in mind that reality is a compound of both, as De Viti also recognized. With a purely cooperative state, public debt, just like taxation, would be voluntarily undertaken. Within this Wicksellian framework, public debt would arise only to the extent that the state's organization of credit transactions is truly more efficient than ordinary market arrangements. We may doubt the veracity of such claims on behalf of public debt, but the ability

of public debt to arise within the institutional framework of a genuinely cooperative state would attest to the veracity of those claims.

The situation is different when monopolistic elements enter the political process. Under the cooperative state, taxes are burdens people choose to bear, just as are market prices. It is thus reasonable to say that people choose to tax themselves. Under various forms of the monopolistic state, however, taxes are impositions by dominant portions of society upon the remainder. For that remainder, taxes are forced impositions. Consequently, people can become forced debtors, in contrast to the cooperative state where there would be only willing debtors.

It is surely plausible to think that republican regimes are some variable admixture of cooperative and monopolistic elements. Regardless of the mix that pertains to a particular regime, public debt is the relevant alternative to taxation. The question for positive analysis concerns giving an account of the parliamentary choice between debt and taxation. The added expenditure will require either higher current taxation or the creation of public debt along with a commitment to higher future taxation to amortize the debt.

It is easy enough to understand why some people would be willing to buy government bonds. This is an ordinary matter of portfolio allocation, with the willingness of people to buy government bonds depending on a comparison of expected returns across different investments. As government promises to repay debt become more reliable, the price that governments have to pay to lenders will decline, which in turn will reduce the level of future taxation implied by the

current creation of public debt. What about the evaluation of individuals of the choice between current taxation and public debt with future taxation to amortize the debt? Here, several analytical possibilities come to mind, some more consonant with the cooperative state and others fitting within the framework of the monopolistic state.

To start, just because the parliamentary assembly chooses to finance the added expenditure through current taxation doesn't mean that all taxpayers have to reduce their current consumption to pay their share of the added tax liability. People who don't want to do this can borrow from market-based lenders, thereby reducing their consumption not in the present but in the future when they amortize their loans. So people who want to pay their added taxes now can do so, while those who prefer to defer those taxes can likewise choose to do so through taking out loans from market-based lenders.

What public debt does is allow everyone to borrow at the rate of interest paid on government debt rather than the rate that accompanies private loans. As an empirical matter, government debt typically carries a lower interest rate than high-grade corporate debt. This simple observation has sometimes fueled the claim that public borrowing is an efficient means of allowing people to borrow to pay taxes. We may grant the empirical observation that government bonds carry lower interest rates than corporate bonds without granting the implication that public debt is thus advantageous for everyone. We would mention two relevant considerations in this respect.

First, it doesn't follow from this comparison of government and corporate borrowing rates that all taxpayers would prefer the government to borrow rather than to tax. When faced with the choice between reducing consumption now and reducing it later, the most likely result is that people will differ in the choices they would make, and with the choice to bear the added tax probably exercised predominately among people with relatively low time preference. The ability to borrow at the government's rate might induce some of those people to shift to supporting borrowing over taxing. Yet so long as there are citizens who prefer to discharge the tax obligation now rather than to defer it, there is no solid basis for claiming that borrowing at the government's rate is advantageous for everyone.

Second, the lower rate of interest on government loans does not imply that the difference in rates entails some genuine cost advantage to loans organized by governments. While the rate differential might give the appearance of a genuine cost advantage, that appearance might be illusory. The lower rate at which a government can borrow surely reflects the lower risk of repayment that people attribute to public debt as compared with private debt. But this lower risk is only part of the story. With corporate bondholders, the risk of poor corporate performance that leads to default on bonds is borne by bondholders. This is not the case with government debt. With government debt, it is taxpayers who bear the risk that government performance is not as strong as was promised at the time the debt was purchased.

For instance, suppose a debt-financed construction project is initially projected to require \$100 billion, and the project receives strong support within

parliament and the public at large in light of that projection. It often happens, however, that such projects end up costing much more than the initial projections called for. The project might end up costing \$200 billion. What are we to make of this situation? It's easy enough to imagine that the project might not have been supported if the initial cost projections were \$200 billion. In the commercial world, this difference in outcomes can be the margin between success and failure. A project that costs \$100 billion might be a commercial success in light of its ability to generate revenues, but at a cost of \$200 billion the revenue stream would be insufficient to keep the firm going. The firm would go into bankruptcy or reorganization, with bondholders perhaps not receiving full return on their bonds.

The situation is different with government debt because much risk is shifted from bondholders to taxpayers. Where corporate owners have limited liability, which shifts some risk to bondholders, taxpayers have unlimited liability, which takes risk away from bondholders. If the cost of public projects rise beyond the cost projection on which initial support was secured, the project doesn't fail and the assets deployed to other uses, for instead it is typically granted a supplemental appropriation. Public and private projects can have equal prospects for failure and yet public bonds can carry a lower rate of interest than private bonds because the risk of public failure is shifted onto taxpayers. Where bondholders typically bear a good deal of the risk of poor performance when corporate activities are financed by debt, they don't bear that risk so much with respect to governments because it is taxpayers who bear that risk through the

proclivity of parliaments to increase budgetary appropriations to cover rising costs.

Beyond this simple point about the locus of risk under different institutional settings, the analytical issues involved are confused by the focus on average borrowing rates. While ten percent might be an average rate of individual loans, there will also be considerable variation in that rate. Some people can obtain loans at an interest rate that might be three or four times lower than the rate at which other people can obtain loans. In this case, public debt becomes involved in processes of income transfer, with public debt operating to allow people who might otherwise borrow at 20 percent borrow at the same rate as people who would prefer to pay cash but are forced to borrow instead.

It seems natural to draw an analogy between business debt and government debt. This analogy, however, is misleading if not false. With business debt, the owners are indebted to someone else. Government debt, however, does not mean that citizens are indebted to someone else. Rather it means that some of them are indebted to others of them. With respect to debt, a government is a financial intermediary. It is like a bank. A bank brings together people who supply credit and people who want to borrow, and it manages their accounts. A government does much the same, save that the debtors become indebted through compulsion. In any case, a government is not indebted any more than a bank is indebted.

What we call government debt is simply the total volume of the credits that some people have extended to others. To the extent a government borrows, the

people who buy the bonds are actually paying taxes for those whom otherwise would have paid higher taxes now. Higher future taxes are the means by which the forced debtors pay their government-intermediated creditors. If debt represents a postponement of tax payments, paying off debt represents a sudden speeding up of those payments. Why would this be a good thing? And for whom would it be good? The alternative to paying off government debt is reducing taxes. Increased spending is not an alternative to reducing debt, because debt reduction is simply one form of spending. By paying down debt, politicians support higher spending over lower taxes.

Why would they do this? For one thing, politicians seem almost universally to resist tax reduction. If faced with a sudden increase in tax revenues, politicians seek typically to spend more rather than to tax less. Paying down the national debt sounds like a form of tax reduction, only with those reductions occurring in the future and not now. Perhaps a brief period of paying down the national debt allows the government to keep its current tax rates in place while putting new spending programs in place. Look at what happened to the massive peace dividend that was to accompany the end of the cold war a decade ago. Taxes were not lowered, they were raised, and several times. Some dividend!

### **3. Ricardian Equivalence Deconstructed**

David Ricardo (1817) noted that there is equivalence between paying a tax now and incurring a liability for debt repayment in perpetuity. With a ten percent rate of interest, paying a \$1,000 tax now is equivalent to paying \$100 in

perpetuity to service a debt. This Ricardian equivalence proposition was resurrected by Robert Barro (1974, 1979) and used to articulate the proposition that government debt has no effect on aggregate spending because it represents no addition to net worth in the aggregate. An increase in government spending would have no stimulative effect because the increased spending entailed increased future taxation, and with the present value of that increased taxation offsetting the spending. The increased government spending would thus entail an offsetting reduction in personal spending, leading to no increase in aggregate spending. There has subsequently arisen a considerable controversy of an empirical character over the equivalence proposition. One pole in that controversy is zero stimulation, the other pole is full stimulation, and much of the empirical work finds support for incomplete stimulation.

Our interest here, however, does not reside in this controversy about fiscal stimulus but resides instead in thinking about the analytics of republican debt. Monarchical debt is congruent with Ricardian equivalence. A monarch who borrows does not increase his net worth any more than a private borrower increases his net worth. The only way that net worth can be increased by the mere act of borrowing is by failing to amortize the loan, which in turn would represent either theft by the borrower or charity by the lender.

It was Abba Lerner (1948) who coined the phrase “we owe it to ourselves.” Over any set of borrowers and lenders, aggregation induces the same claim. This feature of public debt is an implication of double-entry accounting applied to a closed system treated as a single entity. Within such a single entity, the

replacement of current taxation with public debt must entail future taxation of equal present value. Public debt thus becomes just another form of taxation, so public debt is neutered through the simple arithmetic of Ricardian equivalence. To take a public debt of \$12 trillion for a population of 300 million, and to say that each person owes \$40,000 is an arithmetical truism that obscures rather than clarifies thought about public debt. It obscures thought because the act of aggregation obscures the relations among individuals within the polity that have generated the public debt. As a matter of aggregate accounting, Ricardian equivalence must be true because double-entry accounting leaves no alternative when accounts are aggregated across all entities.

What this equivalence shows, however, are the infirmities of orthodox macro-level theorizing and not the genuine equivalence of public debt and ordinary taxation. We must return to basics along the lines of De Viti's treatment of the non-equivalence of taxes and public debt. When public debt is put in contractual terms, two types of contract are involved. One is a contract between a government and taxpayers; the other is a contract between government and buyers of bonds. Government intermediates between the two sets of people, recognizing that these transactions do not have the same voluntary character of ordinary market transactions. While the arrangement with bondholders is voluntary, the arrangement with taxpayers is not and reflects the operation of budgetary processes within a fiscal constitution (Brennan and Eusepi 2004).

With respect to public debt, suppose we ask just who it is that owes the debt. The typical answer would be "taxpayers." To answer "taxpayers," however,

is different from answering “ourselves” because, among other things, there are many residents of a nation who don’t pay taxes and many others who pay small amounts while yet others pay large amounts. In other words, there are relationships among the various members of a nation that have significance and which are obliterated by the orthodox macro analytics of Ricardian equivalence and the treatment of the state as a unitized entity without regard to the relationships among the members of that entity.

The Ricardian treatment neuters public debt through the arithmetic of aggregation. The same potential for neutering pertains as well to personal debt. Credit transactions entail a large number of transactions between debtors and lenders. Ricardian equivalence pertains to each transaction, in that a debtor’s substitution of a future liability for a cash payment involves no change in net worth but merely a reconstitution of a balance sheet. It would be a simple matter conceptually to aggregate all credit transactions. Indeed, such aggregations are commonly performed, as illustrated by references to the total volume of consumer or commercial debt. It would be an equally simple conceptual matter to treat the individual entities that entered into those debt contracts as a single entity. If so, the I-we relationship is replaced by a “we,” in which case it could be said that we owe it to ourselves. Hence, debt would be of no significance and could be removed from an aggregate balance sheet without consequence, in the spirit of the Keynesianesque analytics.

What is significant about public debt is not its aggregate measure but the pattern of relationships among the members of the political entity through which

the aggregate measure is constituted. If public debt is adequately captured by the aphorism that we owe it to ourselves, it would be a simple matter to eliminate public debt—just throw the bonds in the fireplace as Shumpeter (1917) characterized the ending of the crisis of the tax state. The same situation is true, of course, for all forms of debt. Once it is recognized that public debt involves relationships among people, the creation of those relationships and their consequences come into the analytical foreground, with aggregate conceptions receding into the background. In this manner, debt service becomes a fiscal price for each taxpayer. This requires in turn that the setting be liberal and not interventionist, for the productivity of public expenditures must be comparable to market activities within the framework of the cooperative state.

Within a liberal republic the state is a simple intermediary and hence cannot be indebted. Although De Viti's substantial disagreement with Ricardo is clear, he nevertheless tends to downplay it. Ricardo sees no difference between the taxing state and the intermediary state, and it is exactly his failure to see such a difference that led him straight to the equivalence theorem. Ricardo theorized with respect to monarchical public finance while De Viti sought to develop an explanatory framework for public finance within republican regimes, as examined in Eusepi and Wagner (2011). De Viti nonetheless seems to share with Ricardo the idea that public debt allows taxpayers to borrow at the government's interest rate, which, as we noted above, is a false assumption. For it to be true, all individuals should have identical risk preferences, which is inconsistent with a market for credit and with public borrowing. An argument that is overlooked at a

macro level is that public debt implies re-distributional effects, even conspicuous ones in the presence of fiscal illusion. Indeed, fiscal illusion may be intrinsic in democratic regimes with monopolistic and monocentric tendencies. Being a sentient pantagruelic being, the monocentric state is interested in taxation, not in taxpayers; in consumption, not in consumers; and in savings, not in savers.

To convert an “I” and a “you” into a “we,” however, involves more than mere aggregation. It also involves consent among the entities that constitute the “we.” Two people might agree to drive somewhere by car. In this case they would say something like “we” took a drive. But if one of them kidnapped the other, one of them would say I was kidnapped and most certainly would not say that we took a drive. With respect to public debt, questions of who owes what to whom cannot be addressed outside of some presumptions about the institutional framework within which public debt arises.

#### **4. Unfunded Liabilities as Systemic Lying**

What is officially recognized as public debt is typically but a part, and often a small part at that, of the total volume of indebtedness that has arisen through the state’s intermediary activities. In the US, for instance, unfunded liabilities under social security and Medicare have by some estimates been placed in the vicinity of \$100 trillion, which dwarfs the official public debt of around \$14 trillion. When public debt is placed in a contractual setting, unfunded liabilities become forms of systemically generated lying in that they speak to the creation of

promises that knowingly cannot be kept, but which are made anyway because they confer momentary political advantage.

When government is financed by taxation, both the benefits and the liabilities of the budgetary operation are made explicit at that moment. This isn't the case with public debt, though it could be. With public debt, liabilities for future payment are not assigned explicitly to present taxpayers but are left contingent on the subsequent circumstances of taxpayers (Buchanan 1967). To be sure, those liabilities could be made explicit, as Wagner (1986) explores in his treatment of alternative liability rules for the governance of public debt. Rational action with respect to the evaluation of projects requires an ability to compare valuations of projects with costs. But people can't compare costs with their valuations unless they are assigned shares in the cost of debt financed activities.

With ordinary public debt, there is still recognition that current expenditure entails future taxation, only the distribution of those future tax liabilities is left to be decided in the future by the political process and fiscal arrangements in play at that time. With unfunded liabilities a greater measure of deception is present because there is no recognition of the future liabilities involved in present actions. This can be seen by considering unfunded liabilities in terms of the language of contract, recognizing with Charles Fried (1981) that contract speaks to promise and unfunded liabilities point to the knowing making of inconsistent promises.

Think of what an unfunded liability of \$100 trillion means in contractual terms. Again, the state is just an intermediary between the two sides of the contractual relationships that comprise those programs. On one side of that

relationship are promises to people in their capacities as recipients of payments from the programs. There, recipients are promised payments in accordance with some schedule of benefits. On the other side of that relationship are promises to people in their capacities as taxpayers, who are promised that in exchange for those tax payments they subsequently will receive payments when they become eligible beneficiaries.

An unfunded liability means that the promises clash and are not mutually consistent. That the unfunded liability is articulated and estimated as such, moreover, means that the inconsistency among promises is not a surprise but is a systemic product of fiscal interaction. Some promises are made to beneficiaries and other promises are made to taxpayers, and all along the promisors know that they are making promises that cannot be kept. Yet a cardinal principle of contractual obligation is the keeping of promises or the making good on failures to keep promises. An unfunded liability represents an excess of promises made over obligations assigned.

## **5. Concluding Remarks**

Thinking about public debt has been terribly and sadly warped by adoption of a macro-theoretic framework that eliminates public debt as a topic of significant and serious discussion. The Ricardian equivalence that macro-theoretic thinking reduces debt to eliminates any analytical bite that public debt could have. If public debt is just another form of taxation, there is nothing interesting or significant about public debt that is not already taken into account

by tax analysis. And if the analytics of public debt revolves around whether or not it is a source of societal net worth and whether or not fiscal policy stimulates measures of aggregate spending, public debt is hardly a topic worthy of significant analytical attention. To play on Dennis Robertson's (1940) description of Keynes's liquidity preference theory, public debt is but a grin without a cat.

To restore a cat to the grin requires new thinking about public debt, though the direction of new thinking that we have pursued here also has a significant pedigree as we noted in beginning this paper. What is especially significant about public debt is what it says about the constitution of relationships of governance within republican regimes, and how those regimes deal with policies and actions span durations of time. It is doubtful that De Viti's articulation of a cooperative state could ever be fully realized in history, but it is equally reasonable to think that the cause of good republican governance is aided by efforts that move in that direction while being debauched by efforts that feed the monopolistic and monocentric tendencies that are always in the offing due to the Faustian nature of the bargain that political power entails in using an instrument of evil, force over other people, in the hope that more good than evil will result from this instrument, as Vincent Ostrom (1984, 1996) expresses cogently.

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