No, We Don't "Owe it to Ourselves": Contribution Towards a Critique of Conventional Macroeconomic Wisdom, and Why Actually-Existing Public Debt and Monetary Policy is Regressive Policy

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Abstract:

We review literature on the political economy of public debt (i.e., Richard Wagner 2017 *Public Debt*, Paul Krugman 2015 *New York Times*) to help claim contrary to conventional wisdom, that No, we don't owe this debt to ourselves. (Which should be immediately apparent with the more than $3T in US$ denominated sovereign or USG-guaranteed debt held by the Peoples Bank of China, not that there is anything wrong with this). We make our claim fully aware that 'we owe it to ourselves' is one of the hardcore beliefs in the mainstream economics research program, and related policy activism, at the nation-state level. We find that there is no "we" against which to assign public debt and that a Keynesian aggregated view of public finance is derived from a methodological position which fails to model / understand subjective and decentralized human behaviour as an ordering principle. We juxtapose and critique the aggregated Keynesian method, along with some of the analytical tools derived from this method, with that of methodological individualism. Our results show, advancing on those in Wagner 2017, that actually-existing permanent public debt finance, and related monetary expansion and contraction, is regressive policy because it harms those with less disposable income and benefits those with more disposable income, and, that rather than suggesting "we", fiscal illusion about unfunded government liabilities (liabilities ten times that of formal public debt issuance) creates an implicit and/or explicit intergenerational class struggle, negating any "we" as proposed by those endorsing Keynesian debt as neutral policies.

Keywords: public finance, fiscal illusion, intergenerational equity, macroeconomic policy, distribution

JEL Codes: B41, B53, D63, E5, H63

I. Methodological Divergence

Introduction

This research reviews the literature surrounding the political economy of public debt to claim, contrary to conventional wisdom, that 'No, we don't owe it to ourselves'.[1] We make this claim fully cognitive that 'we owe it to ourselves' is one of the hardcore beliefs in the research program of conventional macroeconomics. Specifically, we find that there is no "we" against which to assign public debt, and, relatedly, that the "Keynesian" conventional view of public finance (public debt is what we owe ourselves) is derived from an unsound methodological position as historically-realized.[2]

In what follows we juxtapose the aggregated mainstream ("Keynesian") method, along with some of the analytical tools derived from this method, with that of methodological individualism. Methodological individualism, where we are able to maintain the agency of individuals in the polity (necessary to explain action and change in society), is juxtaposed with Keynesian macroeconomic modeling which necessarily rests on the (thin and unsustainable) assumption of a benevolent dictator for interventionist policy-making. The assumption of benevolence of intent in conventional public finance misses the underlying machinations of individual agency during a budgetary process.

Lerner (1948, 256) introduced the notion that public debt is not a burden on a domestic economy because "we owe it to ourselves".[3] This meme is popularly

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[1] Our literature review is necessarily selective. To discuss the more than 80 years of literature on "macroeconomics" would be an impossibility.

[2] The term "Keynesian" as used here refers to those economists who advocate an activist monetary and fiscal policy to steer the economy through bad times, and who believe that public debt doesn't matter because, in the end, "we owe it to ourselves". We are also calling this "mainstream" economic thought. Schumpeter states that practitioners begin their work with a precognitive vision which informs their analysis, and therefore perhaps then the findings resulting from their analysis. This present research attempts to debunk the "debt doesn't matter" precognitive vision, not the right of the analyst to hold to this vision.

[3] From Lerner (1948, 256),

> A variant of the false analogy is the declaration that national debt puts an unfair burden on our children, who are thereby made to pay for our extravagances. Very few economists need to be reminded that if our children or grandchildren repay some of the

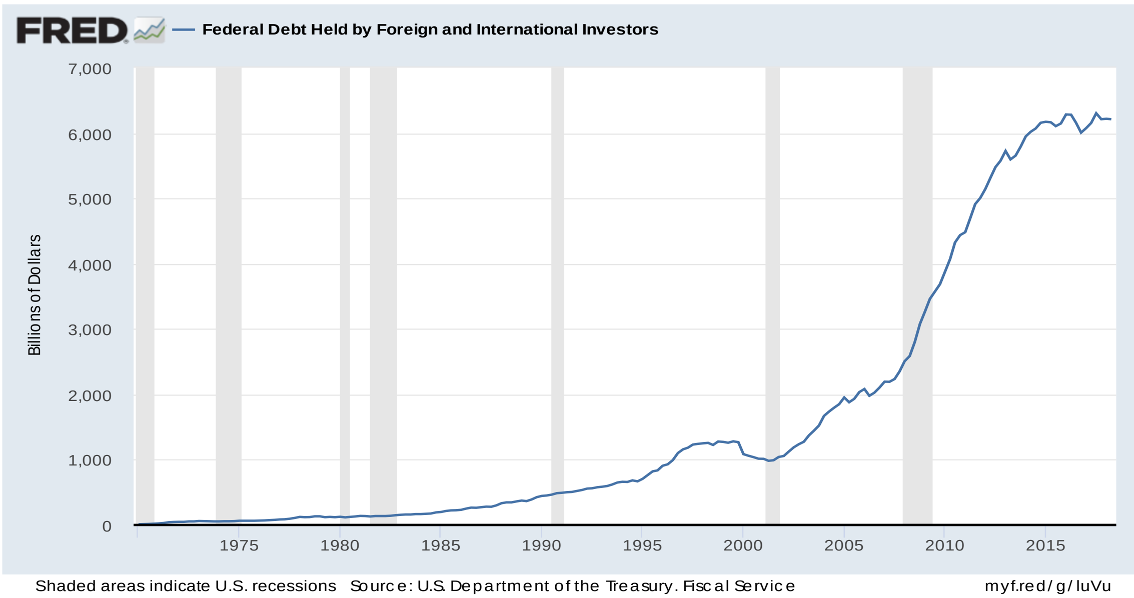
repeated today by Paul Krugman (i.e., 2015. See also Baker and Reznick 2011). However, based on Lerner's original formulation we might be able to end our critique of debt Keynesianism satisfactorily here and now.

Lerner proposed that debt which is owed to foreigners, unlike domestic debt which "we" owe to "ourselves", is a burden on the economy. As of Fiscal Year 2017, the percentage of US government debt held by US government institutions (including the Federal Reserve) is 33.9% of US debt, meaning that 66.1% of public debt is owned by private individuals and institutions, both domestic and foreign. The percentage owned by foreigners is 50.5%, by this measure alone, per Lerner's original formulation, we do not in fact owe it to ourselves.[4] "We" owe it to "Others". We also find that debt held by foreigners has increased significantly since the Fed interventions in response to the 2000-2001 recession and especially since the Quantitative Easing beginning in 2008 (now ended).

national debt these payments will be made *to* our children or grandchildren and to nobody else. Taking them altogether they will no more be impoverished by making the repayments than they will be enriched by receiving them" (Lerner 1948: 256, emphasis in original).

[4] Percentages derived from Eyermann 2017.

Graph 1: Federal debt held by foreign and institutional investors (FRED, FDHBFIN)



This being said, because the percentage of the debt owned by foreigners is not a robust majority (and perhaps not even within the margin of error, and as well subject to historical variation, see Hager 2013, 123), we must continue with our analysis, first deconstructing the fallacy of "we" under democracy in the United States today.[5]

A main reason there is no "we"

Recognition that the size of the polity (the smaller the better) affects the quality of governance has been with us at least from Plato (Spolaore 2006) and through Montesquieu and Adam Smith.[6] Eusepi and Wagner (2017) build upon the work of Antonio de Viti de Marco and other early 20th century Italian public finance theorists to describe how a polity can become so large that representative democracy can become a form without substance.

De Viti starts with the ideal-type of a "cooperative state", where the state acts with the consensus of the people within a polity. Following de Viti, Eusepi and Wagner start with the assumption that there is a sovereign city with 5,000 people and a five-member city council. Each council member represents 1,000 people. It is not hard to imagine that through the personalized nature of this small polity the council members might give their constituency 'the government they (we) deserve', cooperatively.[7] Eusepi and Wagner call this institutional arrangement "substantive" democracy within a "cooperative state".

> By substantive, we mean that council members have numerous opportunities to exchange thoughts and views with constituents in the course of pursuing their daily activities. Just as council members will know quite a bit about their constituents, they will also know a lot about the thoughts and views of the other members of the council. This is a scheme of governance that can operate pretty much in consensual fashion (Eusepi and Wagner, 2017, 96)

[5] Although this paper is most empirically about the United States, it is hoped that some of the ideas contained within might be more general.

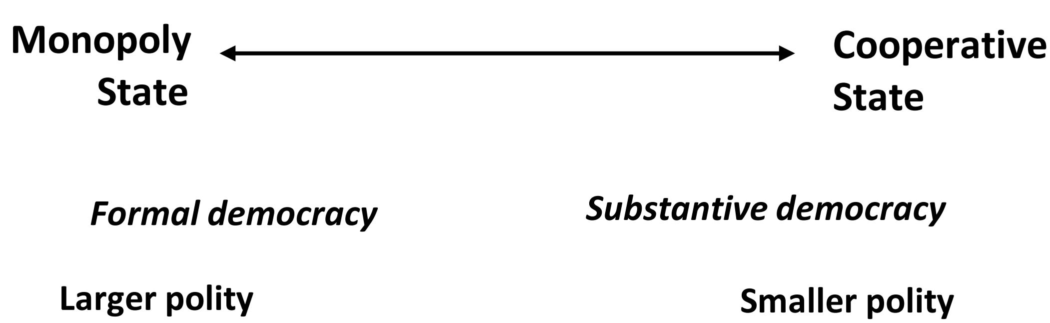
[6] The Anti-Federalist founders understood this 'smaller is better' idea more than the Federalists who supported the Constitution over the decentralized Articles.

[7] We do not claim that there will be 100% consensus even under the idealized cooperative state, only that the percentage of people agreeing with their representative will approach 100%, perhaps, 80% as a relative absolute, but certainly more than a divisive 50.1%

As the size of the polity grows from 5,000 people to 50,000 or 5 million, 50 million, etc., democracy becomes less substantive and merely a formal exercise.[8] Information asymmetries between the people and their representatives, and between the representatives themselves, grow to such an extent that meaningful discussion of issues is replaced by rhetoric around ideological images and promises made to voters for which the median voter is rational to ignore (up to a point).

Within a large polity it is simply not possible to discuss all constituent's concerns in a parliamentary setting, with a goal towards relative absolute consensus. This means that those who control the parliamentary process, who have power-dominance over the representative vote-making order and can (and must, eventually, due to the time-necessitated periodic budget process) bring debate to an end, have a form of monopoly on the democratic process. This is the "monopoly state", the polar-opposite of the "cooperative state" as found in decentralized polity. What constitutes "we" is in the hands of just a few decision-makers in the budgetary process.

Figure 1: Dichotomy between the monopoly and cooperative state (Author, as adapted from text in Eusepi and Wagner 2017)



[8] We could reference Benedict Anderson's notion of nation-states as "imaginary communities" here. It is not necessary for our argument, although it might be helpful.

In substantive democracy, the individual has a cooperative relationship with their political representative(s), the individual considers themselves part of the collective, and can therefore see and understand the "we" of the polity. As the scale of the polity moves leftward along the continuum in Figure 1, representative democracy transforms from a substantive process towards one where political process rule-enforcers gain a monopoly in governance of the state. In this case, as in the modern welfare state of today with large information asymmetries between the governed and those they elect, representative democracy is only a formality without the necessary content to speak of "we".[9] The "we" has become form absent substance.[10]

"We" as (false) tautology

It is true, assuming the public debt is domestically-owned (as it was predominantly during Lerner's time), that we could add up all the public debt owed to those in a polity, and then add up all the future taxes which are needed to pay down this debt, with the result that these two accounting identities would cancel each other out. This aggregation exercise does indeed create a situation where "we owe it to ourselves". We can even assume, as is required to close the conventional aggregated identity, that the borrowers and eventual taxpayers are the same people, or that the tax obligations and interest payments are spread equally to the individual from one generation to the next (this is of course the "Ricardian equivalence", more on which later).

However, this tautology is incomplete in that, as of this writing, the US federal government debt is around $20 trillion, whereas unfunded federal liabilities are 10 times this formal debt obligation, at around $210 trillion (Mauldin 2017). There is no "we" who are recipients of the interest payments on these obligations nor

[9] Information asymmetries mean that special interest groups (the well-organized few, Bastiat's "seen" who support the elected officials with political campaigns) benefit at the expense of the rationally ignorant majority of the populace (who are "unseen" and who are not incentivized to fully understand a size-induced incomprehensible political process). This monopoly state is what the Anti-Federalists warned of during the constitutional debates. Charles Beard finds that within one week of the first US Congress meeting under the newly ratified Constitution there were more than 25 special-interest manufacturing groups seeking trade protection against foreign competition (2004, 42-46).

[10] Rothbard uses radical methodological individualism to show how it is impossible to aggregate state behaviour into a "we", even if all government expenditures are used to purchase so-called public goods. "Even in the case of national defense, which seems to be a particularly strong example of a collective good, the pacifist or anarchist receives a harm rather than a good…." (2011, 467).

taxpayers funding these obligations, because these liabilities are unfunded promises to a minority cohort at the expense of future taxpayers (or "them"). It is simply not possible to use accounting identities to create a "we" for the taxes required to make whole these unfunded liabilities in that these liabilities are not part of a formal contract, and are legally only unfunded political promises. In fact, this situation creates a "class struggle" of those owed unfunded liabilities against those who are net taxpayers implicitly responsible for these collective obligations, whether this generation or the next.

Another reason there is no "we"

Eusepi and Wagner (2017) share the insight that conventional wisdom in macroeconomic policy-making assumes that the state acts as a benevolent dictator, using Acocella (1998) as an exemplar of this type of thinking. Mainstream economists believe that the experts responsible for macro-interventions do so with the best intentions. It is the sustaining of aggregate demand which is of primary concern to Keynesians, not analysis of who actually receives these debt-funded expansionary fiscal policy expenditures. By decoupling the expenditure-side from the revenue-side we cannot aggregate to a "we" and must necessarily resort to benevolence to create an abstracted "we" for macro-policy interventions, ignoring the actually-existing (special-interest rent-seeking) behaviour in the modern welfare state with monopolistic characteristics.

In arguments for debt-financing of government programs (as opposed to individuals borrowing to pay increased tax burdens) mainstream Keynesians claim that government can borrow loanable funds at a lower cost than can individuals. We critique this conventional wisdom next.

I. Fallacy of Government as Low-Cost Borrower

The main fallacy here is that of 'fiscal illusion', a common result in public choice economics. Because the state uses many instruments to extract revenue, it is not rational, nor perhaps possible, for anyone (the median voter if you will) to know the full cost of financing the state. There is not the incentive to be prudent on the expenditure side as there would be under private financing of a cooperatively-determined public good such as a capital project. [11] It may be true (and not

[11] In addition in many jurisdictions government projects must use labor-union labor, at a higher cost in general than non-union labor for the same project (Sampson 2018).

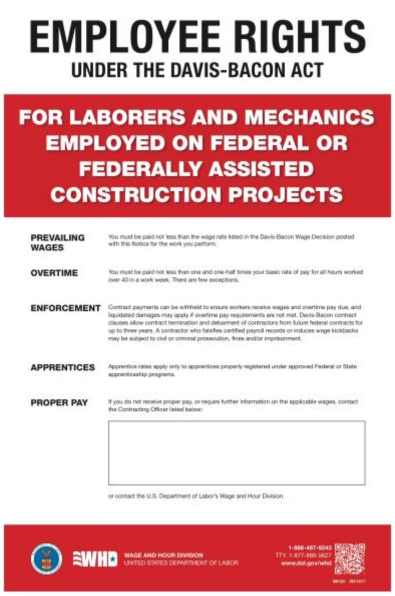
necessary for our argument) that with the legal monopoly on coercion (the power to tax) the state may be able to borrow at a lower rate than individuals, however the excess spending absent residual claimancy means that there is more spending (and thus more debt creation) to fund so-called public goods than there would be if this spending was less opaque.

"In this case, what is represented as a cost saving is a saving to bond-holders that is financed by higher taxes on the remainder of the citizenry who bear that cost through higher future taxes to cover costs overruns and other inefficiencies" (Eusepi and Wagner 2017, 109). It is an empirical argument whether any interest-rate savings make-up for the fiscal illusion, however introspection tells us that this is not so as we see cost-overruns on one government project after another.

II. Fallacy of Ricardian Equivalence

Another instrument in the mainstream toolbox for refusing to acknowledge that state debt-creation has distributional effects is the notion of 'Ricardian equivalence'. Debt-financing today is internalized by taxpayers who expect their taxes to go up equivalently, thus it does not matter if government is funded through taxes or debt. "The result of the irrelevance of the government's financing decisions is the famous Ricardian equivalence between debt and taxes" (Romer 2006, 568).

Even if we accept the equivalence assumption there is a fatal flaw. Ricardian equivalence only uses the *sources* of funds in aggregate, ignoring the *uses* of funds.



The uses of government funds are determined politically, meaning special interests (some people) receive the government largesse at the expense of those who have to use a devalued currency for monetized debt finance (everyone). There, again assuming equivalence, may be a “we” on the sources of government financing but there is no “we” on the expenditure side. This one-sided analysis, of the source-side only, is the key methodological flaw of the those arguing that ‘debt doesn’t matter’. Further, the dialectical tension in policy equivalence is captured by David Romer.

> The Ricardian and traditional view of consumption have very different implications for many policy issues. For example, the traditional view implies that the United States’ large budget deficits are increasing consumption, and thus reducing capital accumulation and growth. But the Ricardian view implies that they have no effect on consumption or capital accumulation. To give another example, governments often cut taxes during recessions to increase consumption spending. But if Ricardian equivalence holds, these efforts are futile. (Romer 2006, 569).

In addition to the irony that the same economists who believe that debt doesn’t matter are usually the same economists who support macroeconomic intervention (which is futile under Ricardian equivalence), we find that rational expectations equating debt and tax funding of government also assumes that these expectations are carried over from one generation to the next. Leaving aside the arrogance of pretending to know today what is best for people tomorrow (those actually making payments on today’s debt), we can ask what is today’s debt buying (investing) for the next generations?

III. Fallacy of Government “Investment” for the Future

We can agree that debt-finance is economically viable if expected returns tomorrow are greater than outlays today, by some discount rate (in this case interest rates on government borrowing). However, this is not the case. We find that self-reported government “investment” is only around 20% of government expenditures, for both at all levels of government and for the federal government alone.

Table 1: Government investment as a percentage of government expenditures; combined for local, state and federal levels, and federal level alone (2Q 2018). Data from FRED (Table 3.9.5), calculations by author

	$ Billions
Government expenditures (all levels)	3507
Gross investment (all levels)	675
Investment % of expenditures	19.20%
Government expenditures (federal only)	1313
Gross investment (federal only)	285
Investment % of expenditures	21.70%

This means that, again looking at uses of funds not just outlays as under the mainstream Ricardian equivalence model, that there is not intergenerational equivalence. Expenditures prioritize consumption today, not investment for tomorrow (and again it is those living tomorrow who will be making onward payments on the debt finance of today).

IV. Why (Permanent) Debt Finance is Regressive

The US government has run a continued budget deficit since at least the Clinton Administration, or, for the last 15 plus years.[12] We can call this “permanent debt financing”. It is expected that the deficit will be around 19% for Fiscal Year 2018. This means that the federal government borrows around 19 cents for every dollar it spends. This also means that we can expect (continued) inflationary money as this aggregated debt is monetized.

[12] There is debate over whether there were indeed surpluses in Clinton administration, this discussion is beyond the scope of, and unnecessary for the arguments in, our paper. Fifteen years is enough to establish a recent history.

Table 2: US Government budget projections for FY 2018 (US GAO[13], calculation by author)

Outlays	$4.1 trillion
Revenues	$3.3 trillion
Deficit	$793 billion
% Deficit Spending	19.3%

For our purposes here we will define the "rich" as those with more disposable income and the "poor" as those with less disposable income. Following Thornton (2018), we can use "Cantillon effects" to help understand the distributional results of monetary policy. We know that inflationary money means less purchasing power for the poor in that they now have to pay more for the means of existence. However, the rich benefit from money printing in that expansionary monetary policy causes asset prices to rise. Only the rich are able to afford investments in the real estate, stock and art markets. Permanent debt finance harms the poor while helping the rich. Therefore we can claim that actually-existing public debt and monetary policy is regressive policy.

V. Our Conclusion: The Public Debt "Class Struggle"

The original class struggle theoretical formulations were made by the French classical liberals around the time of the Napoleonic wars (see Raico 1993). This original class struggle ("turned" by Karl Marx[14]), is productive man being exploited by the unproductive state. We have already found in our paper that government expenditures (and unfunded promises) prioritize those currently living today against those living tomorrow. It can be said that those living today are "exploiting" those who will be living tomorrow. We also find that the 'rich' are exploiting the 'poor' under the current regressive monetary and fiscal policy. In addition and lastly the original classical liberal formulation of the class struggle holds as well.

[13] https://www.cbo.gov/topics/budget.

[14] See my presentation at the Summer Institute for the History of Economic Thought in 2010 on how Marx knew about these writers as found in the archives of his personal correspondence, available, https://www.youtube.com/watch?v=dG0ERDXYdEI&t=1511s

Only net taxpayers are financing the non-debt portions of current government expenditures, these taxpayers (the productive) are exploited by the state (who use current expenditures as means for political support by those who are net recipients of government funds, be it through corporate, or, social, welfare). In a larger context, in a formal rather than substantive democracy, we can say the political class is exploiting everyone else, this is the original libertarian class struggle. In no sense can we say that there is an aggregated "we" when actually-existing debt and monetary policy creates disunity. The categorical class struggles explored in this paper negate the very category of a "we".

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