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Book Reviews

THE POLITICAL ECONOMY OF PUBLIC DEBT: THREE CENTURIES OF THEORY AND EVIDENCE, CHELTENHAM, UK AND NORTHAMPTON, MA, USA: EDWARD ELGAR 2017, HARDBOND: 336 PAGES, 90. ISBN: 9781785363375 BY RICHARD H. SALSMAN

Richard Salsman's book is an effort to combine history of economic thought and economic history perspectives in dealing with issues of public debt. To this end, the author discusses three distinct views on the economic effects of public debt. He starts with what he characterizes the pessimists' view (that is, the public leverage is inevitably harmful to society) and then turns to its exact opposite, namely the optimists (of unlimited leverage). As one would expect he settles down, the middle way characterized as the realists' view. It comes as no surprise that the author takes sides and, of course, he sites with the realists, who opine that "the government can and should provide certain productive services, mainly national defence, police protection, courts of justice, and basic infrastructure, but that social and redistributive schemes tend to undermine national prosperity" (pp. 4 and 260). Naturally, the reader of this review wonders how the various major economists and schools of economic thought are classified in this surprising tripartite division on the economic effects of public debt provided that no economist or policy-maker would accept the characterization of non-realist. Starting from the old classical economists, continuing to Marx, the first neoclassical and Keynesian economists down to the new classical and public choice theorists and also policy-makers all are categorized according to the above three views on public debt.

Salsman in his discussion and evaluation of major economists and schools of economic thought makes a genuine effort to pass judgment on them derived not according to popular beliefs and misconceptions usually arising from secondary literature but rather directly from their own writings. As a result, he quotes carefully and extensively in order to arrive at more definitive conclusions and this is the salient feature and merit of the book under review.

PESSIMISTS, OPTIMISTS AND REALISTS

After this introduction, the reader is wondering about the key features of each of the three approaches and Salsman's answer is disarmingly simple.

More specifically, pessimists are all those that consider deficit spending and rising public debt bad for the growth potential of the economy leading to its insolvency. This is the reason why the pessimists, in principle, are against deficit spending and would like to have instituted, if possible, a balanced budget. Salsman in the pessimists includes major economists and policy-makers like Adam Smith, Thomas Jefferson, Karl Marx, John S. Mill and James Buchanan. The optimists, on the other hand, think that the presence of a number of endemic to the capitalist system market failures necessitate repeated deficit spending, whose accumulation gives rise to mounting public debt. Deficit spending and rising public debt are the antidotes or at least the means to curing the kind of market failure associated with the deficient effective demand and by no means are burdening either present or future generations. Clearly, from the classical economists, Thomas Malthus would be considered an optimist because of his underconsumption theory and the associated with it demand gap, which could be filled through government's "deficit spending as a 'cure' for gluts" (p.82).

In the optimist Salsman includes the Keynesians, though Keynes himself applied caution and further qualifications before the conduct of deficit spending policies. We cannot say the same thing though for his followers, mainly Alvin Hansen and Abba Lerner. Hansen extends Keynes's insights arguing in favour of redistribution of income policies in support of low income groups because of their higher propensity to consume and multiplier; low interest rate policies to reduce the income of rentiers (if their only income was interest) and finally greater participation of governments in capital (infrastructure) investment as a solid step towards Keynes's long-run vision of "socialization of investment". Hansen's 'secular stagnation' thesis, according to Salsman, cannot but lead to ever higher debt-to-GDP ratios. The reason is that as the growth in GDP is stagnating the government will be running deficits in the effort to keep the economy going, inevitably the growth of public debt will exceed that of the GDP; thereby, necessitating higher taxes for the vast majority of people and higher interest payments for the fewer rich. Lerner's thesis is of particular interest for he was arguing in favour of government deficits as a way to generate enough effective demand to stimulate economic activity towards the attainment of full employment equilibrium output provided that prices and wages would be under government's control. This is what Lerner called 'functional finance' as opposed to 'sound finance'. The latter is appropriate to individuals, households, businesses but not sovereign states issuing their own currency. Today Hansen's and, to some extent, Lerner's views for government deficit spending to deal with the problems of secular stagnation of the late-2000s are resurrected by authors like Larry Summers, Paul Krugman, Thomas Piketty, among others, whose views are presented and critically evaluated in the book.

Finally, the realists would not necessarily support *a priori* any view with respect to deficit or surplus spending without taking into account the particular circumstances under which economic policies are conducted. Unlike other authors, who usually describe Alexander Hamilton as a supporter of big government and ever-expanding public debt and in this respect as an optimist; Salsman evaluates Hamilton's own writings on public debt and classifies him as a realist along with host of other authors including Robert Mundell and Art Laffer. I must state at the outset that I find this tripartite division of views on the public debt barren and each of the concepts as too descriptive to be useful in any way; after all, every economist would want to be a realist, that is, his views to be relevant because they are in contact with reality.

ECONOMISTS AND SCHOOLS OF ECONOMIC THOUGHT

The first of the five chapters of the book is based on data from Reinhart and Rogoff (2009) and gives an overview of the evolution of public debt in a number of countries. The reader is informed that public debt to GDP ratios above a hundred percent are not unusual even in major economies, as the data over the last three centuries of the USA, UK and Japan show. Interestingly enough, from this discussion, we get the impression that defaults are rather random events usually associated with debt accumulated during wars and other emergencies and there are no fewer times that defaults occur because of irresponsible governments. Thus, we find countries characterized as "serial defaulters" with Argentina and Greece as prime examples provided that their defaults are on their external debt and that no state has not defaulted, in one way or another, except for six (unexpected) ones; namely, India, South Korea, Malaysia, Singapore or Thailand (p.237). Public debt defaults are more likely to occur during the downturn of the economic activity as it evolves in a long wave-like pattern and in fact by counting the number of defaults, we find that it increases markedly in the downturn of long cycles such as those during the periods 1815-1845, 1873-1896, 1920-1940, 1965-1982, while in the recent Great Recession of the late-2000s, we have what might be called "indirect defaults" (see Tsoulfidis and Tsaliki, 2019, ch. 8).

The second chapter is about the views of the old classical economists

(Hume, Smith, Ricardo and Mill) and covers the pessimistic economics of Thomas Jefferson, who was inspired by the Physiocrats and their particular notion of surplus generated exclusively in agricultural production. Jefferson favoured policies which limited government expenditures because they reduce the social surplus and, therefore, the investible in agriculture product and diminish the economy's wealth-generating capacity. The realist, on the other hand, Alexander Hamilton was in favour of government expenditures provided that there are institutions in place to restore normality, that is, balanced budgets and low debt. Marx, according to Salsman, is with the pessimists, on further thought, however, we discover that this is not exactly right because Marx rejected Say's law and placed the priority of investment over saving, while his distinction of productive-unproductive labour and related activities which when combined with various hints scattered throughout Marx's writings lend support to the view that public debt may not be harmful for capital accumulation. In effect, there are unexplored clues in the works of Marx that would place him somewhere between the old classical economists (sharing with them the idea of surplus and its estimation through labour time, production and non-production labour and activities, among others) and Keynesian views especially for the role of effective demand in recessionary or depressionary situations. As for the views of the first neoclassical economists, we find that they abhorred deficit spending and rising public debt, however, they did not necessarily share the same rationale with the classical economists. In particular, the neoclassical economists are usually described as accepting Say's law with the difference that the equality of savings and investment is brought about through the variations in the interest rate. Furthermore, rising public debt means increasing government intervention in the markets and so competition is distorted leading to results below the social optimum ones.

At this junction, we cannot but take issue concerning Salsman's treatment of the old classical economists in general and Marx in particular, who in our view share, among other things, the key concepts of surplus, productive and unproductive labour and related activities, and the identity of savings and investment, although as we mentioned above, Marx was critical to Say's law and gave, as Keynes did, priority to investment over savings. If the social surplus is consumed unproductively, for example in the administration, provision of justice, security, protection and other public services, it follows that it becomes detrimental to capital accumulation and economic growth. This is clear in Smith, Ricardo, J.S. Mill and the other classical economists (including Malthus), who thought that the financing of government expenditures through loans reduce the amount of savings which would have been invested in the private sector. If the government spends this money on investment projects, such as the provision of the infrastructure there would be no negative effects. The reduction of private investment would be matched by the increase in public investment and eventually, public debt will be repaid through the taxation of rentiers' income.

Hence, the distinction between financing government expenditures through taxation or borrowing, that is, by issuing government bonds becomes crucial. Smith and Ricardo were crystal clear about the differential effects of the alternative modes of financing. The idea is that taxes fall directly on currently earned income destined mainly to consumption and so private consumption expenditures are expected to fall by the same amount that public expenditures increase and so the net effect on the economy's growth rate will be nil. The same would not be true in the case where the money is drawn through borrowing because the latter does not fall on consumption but rather on savings, that is, investment. Ricardo developed a more sophisticated scenario, where taxes fall either on necessary commodities (indirect taxes) or on wages (direct taxes) but real wages are not affected even in the short run, because the government with the taxes that it collects competes with the private sector (whose funds to employ labour remain the same) in the labour market over a given supply of labour raising wages and restoring workers' losses through taxation, which is ultimately paid by the rich consumers (capitalists and landlords). All these lend support to Ricardo's non-equivalence theorem, which Salsman is very careful to agree with (p.80), however, without presenting and evaluating the rationale for the non-equivalence of taxation and borrowing which is left to the readers' inquiry.

It is important to point out that the seeming equivalence of taxation and borrowing was very convenient and in effect was used by Robert Barro initially and subsequently it became a constituent component of the New Classical approach according to which domestic debt does not have any adverse wealth effect on private savings. The rationale is that when the debt to GDP ratio increases, the households are supposed to be endowed with 'rational expectations' manage to predict that future taxation will increase and so households increase (decrease) their savings (consumption) or what is the same thing reduce their permanent income. As a consequence, the impact of domestic debt falls on consumption rather than on savings, avoiding the detrimental effect on the saving rate. A similar operating mechanism is activated in the case of international debt whose redemption takes place via the sale of assets to international institutional agents. Such a possibility raises, once again, the question of limited future government income and, hence, the inevitable future increase in taxation. As a consequence, the final effects of deficit spending are the same regardless of the mode of their financing.

Very similar to Ricardo's is J.S. Mill's main position, although he uses more elaborated arguments according to which public debt may not have the pernicious effects on the economy if its financing comes from foreign savings and also if the borrowed money is spent productively, or if the private sector spends unproductively and does not invest productively the available savings. Salsman (p. 248) discovered in J.S. Mill a criterion or a 'rule of thumb' for the pernicious effects of public borrowing and that is the level of the interest rate. More specifically, if borrowing leads to higher interest rates then this is *prima facie* evidence that the state is in direct competition with the private sector in the money market and savings are diverted from productive investment to government consumption or in general unproductive expenditures to the detriment of capital accumulation. It is important to note that J.S. Mill defended his position to critiques of the short that the higher interest rates are the result of rising profit rate as it was the case during the Napoleonic Wars. He counter-argued that this is what precisely one expects because of the government's borrowing for consumption purposes deprives the private sector from investment funds. Consequently, investment slows down and workers compete with each other for employment positions by reducing their wages thereby increasing profits and the rate of profit. In this case, an already rising interest rate may be rising even more as a result of falling wages and the rising rate of profit (Tsoulfidis 2013). It goes without saying that when the government increases its borrowing and the interest rate, other things equal, remains the same, we may argue that government at least does not compete with the private sector and borrowing may even have positive economic effects if invested productively.

That having been said, one wonders what to suppose if interest rate (say on the 10-years bond or Treasury bill) keep falling as is the case since the early 1980s and in recent years through quantitative easing. The answer might be, on the one hand, in the changing demographics and, on the other hand, in the rate of profit (actual or adjusted by capacity utilization) whose level (in the US economy) is by far lower than that of the 1960s and since 1997 is in a downward direction (see Tsoulfidis and Tsaliki, ch. 10). The low profit rates discourage investment spending and the financial institutions, whose "output" is loans, are bound to lower the price of their output, that is, their interest rate in order to encourage investment activity. However, the lower interest rates require much more lending of the financial institutions in order to get the same amount of interest income and in so doing they tend to overestimate their own financial position as well as that of the borrowers. Lower interest rates encourage government borrowing and deficit spending leading to ever-rising debt. Meanwhile, in the real economy the incentive to "invest" in financial assets, that is, in "speculative investment" is often by far more attractive than that in the "enterprise investment" to remind Keynes's important distinction that describes pretty well the current predicament in major economies.

From the discussion of chapter 2, the name of Marx could not be missing and Salsman to his credit makes valiant efforts to discover order in Marx's sporadic remarks about taxation and debt and the conclusion he arrives at is that of 'incoherence'. However, a closer look in Marx's work would reveal that he was simply collecting materials which according to his plans would constitute a separate book on *State* based on developments of his main book *Capital*. In such a book "the laws of motion" of capitalism would be expanded to address questions regarding the incidence of various taxes on prices and capital accumulation as well as their effects on income of social classes, finally, the problem of financing of government expenditures and public debt with its broader economic implications on social classes. Unfortunately, Salsman rushed to subsume "Marx's views" along with those of the pessimists, that is, a highly heterogeneous group of economists and contesting economic theories. The chapter continues with the views of the first neoclassical economists who were very much occupied with their marginal analysis and what came to be known as microeconomic theory; as a consequence, they did not pay much attention to broader issues and therefore public debt could not be on top of their research agenda. It seems that classical ideas were prevailing even in the first decades of the twentieth century and that the first major neoclassical economists were in agreement with the policy conclusions of the classical economists about the minimal government expenditures and to its no interventionist character in the economy. In short, neoclassical economists (not all) are considered pessimists when it comes to issues of public debt for reasons quite different from those of classical economists. Interestingly enough, in the list of economists and their categorization in the Appendix of the book (p.263), Salsman does not include the pioneer neoclassical economists not even those of the inter-war period.

The third chapter surveys the views of John M. Keynes and well-known Keynesian economists, Alvin Hansen, Abba Lerner, and Richard Musgrave among others, not necessarily Keynesians proper (Arthur Pigou of the post-1930s!) all of them assigned to the optimist camp. Starting with Keynes, whose views with regard to the economic effects of public debt changed over time although he did not argue deficit spending is innocuous and so in a sense he was a pessimist. On further examination, however, we find that Keynes did not mind rising public debt but not at levels that could not be controlled. He argued the case of 'implicit default', that is, to inflate the way out of debt by printing more money or its debasement in some way. This is not unusual and one needs not to resort to Keynes's theoretical views and interwar experience from Germany, we do know for example in the case of the Greek pre-WWII national debt (the 'domestic' and not the 'external' one) of a few billion drachmas which was completely extinguished (along with the savings of the public) in November 1944 when the Greek government set the conversion rate of one new drachma equal to 50 billion old ones, lending support to all those who argue that a state cannot default provided that its debt is denominated in domestic currency. A view argued by Lerner but also by the Modern Monetary Theorists (MMT) and most Keynesian economists attribute to the state such debt-cutting powers. In the case where the debt is denominated in a foreign currency (USD), its redemption cannot be other than by the selling of public assets.

Salsman (pp. 116 and 120) refers also to Keynes's idea, whose background, in our opinion, is the classical distinction of productive and non-productive expenditures combined with the theory of effective demand. Thus, Keynes wanted a balanced (and if possible, surplus) operating budget, when it comes to government's consumption or unproductive expenditures and he would not mind a deficit public investment budget. This combination is worth supporting because on the one hand it creates employment and new wealth and on the other hand, if it increases the debt at least, we end up with the valuable (infrastructure) investment which can be gainfully used in the present and future. However, the same is not true for the government consumption expenditures, which once the money is spent; it is gone forever, unless there is underutilization of capacity and may increase employment, income and savings. After this discussion one is wondering with such policy proposal why Keynes should not be considered as a realist? In that, his ideas are very pragmatic and take into account the positive and negative aspect of deficit spending.

The fourth chapter titled "Public Choice and Public Debt" deals primarily with precursors to the public choice school economists and their views on public debt. From these economists, Antonio de Viti de Marco and Ludwig von Mises figure prominently. James Buchanan and Richard Wagner are public choice scholars proper and their views become the focus of this chapter. For them, the public debt is essentially deferred taxation paid ultimately by future generations and what is worse in conditions of "unlimited democracy" the ruling political parties are "incentivized to maximize spending and minimizing taxation" (p.213) in their effort to maximize votes. Buchanan's "critical threshold" is attained when the interest payments are equal to the annual budget deficit; in this case, the government borrows to pay for interest on the interest of its past borrowing. Under these circumstances, the growth of public debt starts to accelerate, if interest payments exceed deficit and the economy enters into a "debt spiral" in its way to the default zone (p.222). Hence, Salsman (p.223) cites approvingly from Ernst Hemingway's "The Sun Also Rises" where one character asks: "How did you go bankrupt?" and the reply is: "Two ways, gradually then suddenly". And in a nutshell that describes how so many individuals, businesses and governments get trapped into the debt spiral and finally abrupt default. The public choice approach considers public debt harmful unless is constitutionally arranged that the provision of public goods and services are paid for.

Chapter five on the "Limits of Public Debt" is particularly relevant for those concerned about the long-run effects of rising public debt. Hence, Salsman points out to a number of key variables associated with the historical evolution of debts and the conditions leading to defaults. Unlike Rogoff and Reinhart (2009) who restrict their analysis to a single variable, that is, the debt to GDP ratio, and the notorious and dubious 90 percent threshold level (for the World Bank the threshold is set at 77 percent provided that it remains at this level for an extended period of time) which once attained slows a country's economic growth down and the likelihood of default increases. Salsman introduces variables such as a country's taxable capacity along with the monetary regime and argues that if a country's borrowing is in its own non-convertible to gold, or foreign denominated (e.g., USD) currency, explicit default is unlikely to occur because these countries, mainly the economically advanced ones, can inflate their way out of their debt (implicit default) or via financial repression (as it was the case with the various bail-outs during the outbreak of the Great Recession in the late-2000s). Under these circumstances, it is possible for these countries to sustain a far greater debt to GDP ratios and for a longer time period, a case which is against the pessimists' (whoever they are) views. This does not mean that the optimists are right; to the contrary, Salsman finds that the high level of state consumption expenditures and the rising debt to GDP ratios entail a cost to economies, and that is the slowdown in their economic growth.

The final chapter is a summary of the book with some concluding remarks. In his summary Salsman reiterates the tripartite division of the optimist-pessimist-realist categories for public debt theorists and advises against unchecked democracy which promotes fiscal irresponsibility leading to rising debt. The characterizations might be effective in attracting the readers' attention because of their disarming simplicity and ease with which one can classify economists; however, scientifically speaking they are not operational because they shadow the underlying mechanisms that stand behind the phenomena. For example, classical and neoclassical economists would oppose to rising public debt for quite different reasons dictated by their respective economic theories. Classical economists mainly because government expenditures are a drain on the surplus produced; by contrast, neoclassical economists would argue that government expenditures past a point make the economy to depart from the perfect competition ideal. Government's role should be corrective in the various market failures and make economic life look more like the perfectly competitive one. As a consequence, government spending beyond the absolutely essential interferes with and becomes an additional impediment to the free operation of competition leading the economy to suboptimal positions.

CONCLUDING REMARKS

This is a scholarly written book for those interested in the intellectual history of economic theory and the views of major economists and also policy-makers on the issue of public debt. Certainly, there are not many books that deal with the public debt and its economic effects in the long run. In the first post-war decades the issue of public debt did not appear formidable and the macroeconomics texts relegated the topic in the last chapters with the warning to avoid the so-called "fallacy of composition", that is, what is true for the individual behaviour (spending within one's budget constraint) is not necessarily true for the state which can run large deficits because of its taxing, borrowing and printing of money capacities which are not available to the same extent to individuals. This does not mean that there were no cases of state defaults in the 1970s or 1980s during the stagflation crisis; to the contrary, besides the "usual suspects", that is, a number of Latin American and African countries among others coming to the brink of default (Greece was such a case during 1989-1993, Asian countries in 1997-1998 financial crisis). The situation changed, especially in the US economy which in the years 1998-2001 was running budget surpluses and economists were arguing that public debt will not be a problem in the future since it could be easily brought down to zero. The following years continues deficit spending led to rising public debt as a result of war preparations and actual wars. The public debt accelerated during the Great Recession of the late-2000s which led to increasing government expenditures and the public debt became a problem even for the US economy, which since 2012 is running debt to GDP ratios above 100 percent.

Salsman often gives the impression that domestic debt may not be a problem, which is true in a sense that in recessionary periods, deficit spending mainly on consumption saves jobs, as we know from the case of Japan. However, the cost of this kind of spending, in our view, might be the prolongation of the slowdown in economic growth since the potential investible product is diverted to non-production activities. Furthermore, Salsman does not connect the views on public debt of various authors to their underlying theories and rushes to taxonomize each economist and school of economic thought into his tripartite scheme without taking into account fundamental theoretical differences. Ricardo, Marx and the first neoclassical economists by no means can be classified in the same group. Another interesting issue is that in Salsman's view, public debt determines rather than being determined by the stage of the economy. The available empirical evidence (see Tsoulfidis and Tsaliki, 2019, ch. 8) shows that the arrow of causality is, more often than not, the other way around. As a consequence, broader issues such as the Great Recession of the late 2000s along with others appear as if they were the result of political decisions arising in parliamentary democracies and the competition of political parties for votes leading to lower taxes and higher spending and the accumulation of deficits to rising public debt.

This is not quite true as this can be judged from a host of countries known for their social-democratic institutions such as Denmark or Sweden along with many EU countries having in 2019 public debt to GDP ratio well below 50 percent. Switzerland is another example of a country with more immediate democracy than any other country in the sense that decisions on many important (and also less important) issues including taxation often are taken directly through referendums. The debt to GDP ratio in this country currently is at 41 percent. Regrettably, Salsman argues that the democratic institutions are found responsible for the rising debt and so his preference is limited democracy of the late 19th century (less profligate - public spending) regardless of slavery as in the case of the USA and in general limiting voting rights.

Finally, despite issues that we dealt with in this review we do not want to undermine the importance of Salsman's contribution to the history of public debt. On the contrary, the book is scholarly written and from the very few on such a crucial question as public debt. The discussion of economists and schools of economic thought is very careful and thought-provoking. The reader may find a wealth of information and economic history examples which could be used profitably to enhance our understanding of such a currently serious problem as public debt.

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