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CHAPTER SIXTEEN

THE GOLDEN RULE OF PUBLIC FINANCE AND PROSPECTS FOR ITS REVIVAL

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The golden rule of public finance (GRPF) holds that if governments borrow, they should do so primarily for productive, not consumptive purposes. A principle of fiscal prudence, the GRPF condones net borrowing by sovereigns, over the course of a cycle, only to create capital goods that yield a return and foster private-sector productivity, not to fund ordinary expenses or redistributive transfers that undermine prosperity, curb tax revenues, and jeopardize debt servicing. Public debt is justifiable, serviceable, and sustainable if it is issued mainly to fund durable, income-producing assets, not if its proceeds fund ephemeral or wasteful consumption; it is warranted only to the extent it helps *create wealth* over future decades, not to the extent it *redistributes or destroys wealth* in the present.[1]

As a fiscal norm, the GRPF has faded over the past century or so, in both theory and practice. As an informal institution, it still has its defenders, but its defense remains a minority view in public finance scholarship.[2] A norm of fiscal prudence has given way to a passive resignation to the "inevitability" of fiscal profligacy. Once a key aspect of 19th-century Victorian-Gladstonian principles of public finance,[3] the GRPF was abandoned piecemeal beginning in the 1930s, amid the financial turmoil and fiscal profligacy of the Great Depression, and thereafter, amid the vast public financing requirements of World War II. As a reputable rule, the GRPF faded further in the decades after the last vestiges of the international gold standard were jettisoned in the early 1970s. In recent decades only a handful of sovereigns (including Germany and the UK) clung to some form of GRPF; but they abandoned the rule when they succumbed to the avalanche of public debt and monetization that accompanied and followed the 2008–2010 financial crisis and global recession.[4] Debt finance is barely mentioned in today's top-selling public finance textbook, and the GRPF is ignored entirely.[5] Faint calls for a diluted GRPF now come only from those who fear that "austerity" budgets and the successive diminution of "fiscal space" globally will deter public investment and prevent a full resort to deficit spending in future recessions.

The erosion of long-held golden norms in fiscal and monetary affairs alike is neither random nor inexplicable; it reflects a deeper erosion in the golden rule of morality, which holds that as individuals we should treat others as we wish others to treat us in turn. This reciprocal ethical norm undergirds fair dealing, nondiscrimination, and the equal protection of the law; its erosion, in contrast, permits unequal, unjust treatment, which typically becomes codified in law, politics, policymaking, and public finance.

FOUNDATIONS OF THE GRPF

Two justifications are typically offered for the GRPF, the first primarily economic, the second moral. The *economic* justification for a golden rule in public finance echoes the corporate finance principle that debt is more likely to be fully serviced (via payments of principal and interest) if its proceeds are deployed to create the future income streams upon which debt service crucially depends. Loan proceeds should finance capital assets that yield a return (or make the economy more productive than it might otherwise be), not consumable goods or services that yield little or nothing. Even in household finance, debts incurred to buy homes, autos, appliances, diplomas, and vacations are not serviceable without an adequate income earned from productive activity. Nothing inherent in public finance exempts governments from the need to abide by these principles; and failing to abide by them, nothing prevents governments from suffering fiscal, monetary, and economic failure.

The second justification for a golden rule in public finance is mainly *moral* and holds that it is only fair that citizens pay for what they get and use; current generations should not have to shoulder (by taxes) the entire cost of durable public goods created today, which will benefit future generations; the latter should pay most of today's cost via future taxes, to help service previously incurred public debt.[6] Nor should future generations be burdened by public debts conveyed to them by ancestors, unaccompanied by productive and remunerative assets that help service the debt.[7] This justice-oriented benefits principle is as applicable to debt-financed public spending as it is to tax-financed outlays. Its counterpart, which has become dominant in recent decades, is the ability-to-pay principle, which severs the link between cost (payment) and benefit (use) and requires, in essentially socialist terms, that the state secure funds "from each according to his ability" and transfer them "to each according to his need."[8] This is most clearly seen when future generations are burdened with current welfare spending on the assumption that because they will probably be wealthier, they will better be able to pay for it.

The GRPF has rarely been codified in law, nor has it been strictly stipulated as doctrine in the constitution of any nation.[9] Some governments in recent decades have adopted deficit limits, debt caps, and spending "brakes," both constitutionally and statutorily. But during recessions and financial crises these legal boundaries have been readily breached, without much official concern to effect a remedy.[10] The best example is the European Union's Stability and Growth Pact, in place since 1998.[11] The pact has never embodied a GRPF, however. Yet for at least a century prior to the 1930s, before the spread of Keynesian notions, the GRPF was a widely recognized and broadly practiced *informal* fiscal norm.[12]

Although the GRPF has been abandoned, no widely accepted alternative fiscal norm has replaced it. More than a half century ago, James Buchanan discerned and critiqued what he called "fiscal nihilism"—the rejection of any and all fiscal rules per se.[13] In the past decade, Keynesian premises and principles, widely discredited in the 1970s, have seen a revival. In place of a fading GRPF, a nearly opposite norm presumes that federal spending for consumption is acceptable—indeed indispensable, reflecting the persistent Keynesian fear of inadequate aggregate demand—and that this spending should be financed not by higher taxes (which might reduce aggregate demand) but by the issuance of vast new sums of public debt, even if the debt is not likely to be fully serviced.[14] An alternative approach, using the doctrine of "Ricardian equivalence," denies any material difference between tax and debt finance, and it therefore sees no problem with borrowing to consume.[15] As for unsustainable public debt and default risk, some argue that public bondholders' astute and heightened expectation of default provides ethical cover for sovereigns to default deliberately.[16] This idea could become the new norm in future decades: publicly consume by borrowing, then default *on principle*. A recent work, reversing causality, insists that defaults on public debt can rectify an alleged harm inflicted by private creditors. This presumes that public over-indebtedness is due not to predatory borrowing by a profligate state, but to predatory lending by bondholders who could have lent elsewhere but chose to lend to a state.[17]

EROSION OF THE GRPF

Metaphorically, the GRPF might be pictured as a "finger in the dike" which necessarily fails to stop a flood of fiscal profligacy that originates in unrestrained democratic choice. If the problem is political, not economic, an eroded GRPF is the effect, not the failed preventive, of public debt deluges.

Over the past century, four fiscal phenomena detrimental to the GRPF and to economic prosperity have become the norm in the United States and in other major economies. First, public spending has increased both in real terms and relative to GDP. Second, the composition of public outlays has shifted from traditional capital spending (infrastructure) to spending on consumption (intangibles, including income transfers, health care, higher education, and various "social insurance" schemes). Third, to fund increasing public consumption, governments have come to rely more on debt finance (and unfunded "entitlement" promises) and less on tax finance; in the latter case, some states have become reliant

TABLE 16.1

U.S. federal revenues, spending, and debt, 1819–2018

	Average share of GDP				
	Years	**Revenues**	**Spending**	**Differential**	**Debt**
Prior 100 years	1819–1918	2%	3%	0%	9%
Past 100 years	1919–2018	14%	17%	–3%	55%
Prior 50 years	1919–1968	11%	14%	–3%	50%
Past 50 years	1969–2018	17%	20%	–3%	59%
Prior 10 years	1999–2008	17%	19%	–1%	62%
Past 10 years	2009–2018	16%	21%	–5%	100%

Source: U.S. Office of Management and Budget, "Historical Tables," Table 1.1., https://www.whitehouse.gov/omb/historical-tables/.
Note: GDP = gross domestic product.

on a narrow subset of (richer) taxpayers, versus less-taxed or untaxed citizens. Finally, public obligations have increased not only in absolute terms but relative to GDP (i.e., public leverage has increased).

Focusing on the United States, Tables 16.1, 16.2, and 16.3 illustrate material shifts in the pattern of U.S. public finance in recent decades. Federal outlays averaged 17 percent of GDP over the past century compared with just 3 percent over the prior century, and they have averaged 20 percent of GDP during the past 50 years compared with 14 percent during the prior 50 years (Table 16.1). Deficit spending outside of wartime was rare in the century prior to 1918, but the budget differential has averaged –3 percent of GDP since then; the differential has averaged –5 percent of GDP over the past decade, causing a rise in federal debt as a share of GDP to an average of 100 percent over the past decade compared with 62 percent over the prior decade (Table 16.1). During these two decades the spending share of GDP has risen, while the revenue share has declined.

As for the composition of federal spending, U.S. public investment has diminished over the past half century relative to increases in social spending and transfers. U.S. budget analysts conveniently distinguish spending

TABLE 16.2

U.S. federal spending by type, 1962–2018

	National defense	Human resources	Physical resources	Net interest	Other
Year	**Share of total federal spending**				
1962	49.0%	29.6%	8.3%	6.4%	6.7%
1990	23.9%	49.4%	10.1%	14.7%	1.9%
2018	15.4%	72.8%	3.3%	7.4%	1.1%
Year	**Share of nominal GDP**				
1962	8.9%	5.4%	1.5%	1.2%	1.2%
1990	5.1%	10.5%	2.1%	3.1%	0.4%
2018	3.2%	14.7%	1.0%	1.5%	0.4%

Source: U.S. Office of Management and Budget, "Historical Tables," Tables 3.1. and 9.1, https://www.whitehouse.gov/omb/historical-tables/.
Note: GDP = gross domestic product.

on physical resources versus human resources, each of which excludes defense spending.[18] Spending on physical resources has decreased relative to all federal outlays, from 8.3 percent in 1962 to just 3.3 percent in 2018, while outlays on human resources have increased from 29.6 percent of the total in 1962 to 72.8 percent in 2018 (Table 16.2). To accommodate this shift, military expenditures have declined from 49.0 percent of the budget in 1962 to just 15.4 percent in 2018. Interest expense now comprises a budget share (7.4 percent) more than double the share devoted to investment (3.3 percent) and more than it did in 1962 (6.4 percent), albeit less than it did in 1990 (14.7 percent) due not to less debt but to lower interest rates.[19]

Real growth in U.S. federal spending on "major public physical capital, research and development, and education and training," including defense outlays (Table 16.2), has decelerated from 2.5 percent per annum between 1962 and 1990 to just 1.0 percent per annum between 1990 and 2018.[20] As a portion of all spending, such outlays have declined steadily from 32.3 percent in 1962 to 18.2 percent in 1990 and 12 percent in 2018. Growth in nondefense investment spending has decelerated more, from

3.7 percent per annum (1962–1990) to just 1.8 percent per annum (1990–2018), and now comprises just 7.3 percent of all federal spending, down steadily from 9.0 percent in 1962 and 7.7 percent in 1990. Nondefense federal investment spending has never been a large share of total output, but it is now just 1.5 percent of GDP, having averaged 3.0 percent of GDP from 1962 to 1990 and 1.8 percent of GDP from 1991 to 2017. In contrast, gross private domestic investment has averaged 18 percent of GDP since 1962 (in a range of 13–21 percent),[21] and its growth has not decelerated: in real terms it has been steady, at 4 percent per annum from 1962 to 1990 as well as from 1990 to 2018. Whereas the private sector invested $3.4 trillion in 2017, the federal government invested less than a tenth of that ($278 billion), albeit supplemented by another $364 billion spent by state and local governments.[22]

Even if all public investment was value-adding and helped boost the productivity of the private-sector economy, it has undeniably diminished in recent decades, due not to stricter commitments to budget balance or fiscal austerity but to ideological-political commitments to more consumption-oriented social spending and transfers. The shift in spending priorities may partly explain the deceleration in private-sector productivity growth since the 1970s. Real output per hour worked in the U.S. business sector grew by a compounded rate of just 1.9 percent per annum between 1970 and 2018, a pronounced deceleration from the growth of 3.3 percent per annum registered between 1947 and 1970.[23] The shifting composition of public outlays from investment to consumption may explain a large part of the productivity decline, and federal spending can explain even more of the decline to the extent that public capital spending itself has been wasteful.

Even if the GRPF had been strictly followed in recent decades, with the result that far less public debt was incurred (being ineligible to fund social-consumptive outlays), it might not have helped the economy maintain or increase its previously high-productivity growth. Although the GRPF can preclude public borrowing to fund consumption, it cannot preclude a material and sustained shift from productive (investment) spending to consumptive (transfer) spending. Nor can the GRPF ensure that public investment will be productive, or more so than private investment. The GRPF might preserve productivity gains because, to the extent it requires consumption spending to be tax-financed, it might encourage taxpayer resistance to such spending; but likewise, ideological and electoral support for social spending can motivate politicians to fund it by less-painful, less-visible ways, such as debt finance.

Having documented empirically the material shift in U.S. federal spending volumes and patterns over the past century, it's helpful also to consider concomitant changes in money, public debt, and output. Table 16.3 reveals that while federal debt and the money supply have grown more quickly over the past half century (1969–2018) compared with the prior half century (1919–1968), real output has grown less quickly. Faster rates of debt and money creation haven't translated into faster economic growth rates. Real output growth has slowed further over the past decade (2009–2018) compared with the previous one (1999–2008), as debt growth has accelerated from 6.7 percent per annum to 7.2 percent per annum.

SHOEHORNING EVER MORE SPENDING INTO THE GRPF

An erosion of the integrity of the GRPF is also visible today as a result of attempts to rationalize all types of government spending. Historically, besides tangible public capital (infrastructure), there has always been semi-intangible public capital (services), including national defense, the courts, and law enforcement. Government at its best provides justice, and the constitutionally limited, fiscally responsible state does that job best. "Social justice" acolytes, in contrast, command sovereigns to flout principles of plain justice by redistributing income and wealth. Those hoping to preserve and extend the size and scope of government may acknowledge the validity of the GRPF but nevertheless applaud its abandonment. To the extent that careful studies have revealed redistributive "social spending" schemes to be detrimental to productivity and living standards,[24] a temptation has emerged to reclassify public consumption as "public investment." Politicians in recent decades have pledged more public spending not only for traditional, tangible infrastructure (roads, bridges, tunnels, ports, power grids) but also for "investment" in "our

TABLE 16.3

U.S. federal debt, money supply, and output, 1919–2018

		Compounded annual growth rates			
	Years	**Debt**	**Money**	**IPI**	**GDP**
Prior 50 years	1919–1968	5.5%	4.8%	4.2%	3.8%
Past 50 years	1969–2018	8.6%	8.5%	2.1%	2.8%
Prior 10 years	1999–2008	6.7%	11.9%	0.4%	2.6%
Past 10 years	2009–2018	7.2%	7.7%	1.7%	1.9%

Sources: Historical Statistics of the United States, U.S. Department of Commerce, Federal Reserve; Federal Reserve Bank of St. Louis, Monetary Base (total), FRED Economic Data, https://fred.stlouisfed.org/series/BOGMBASEW; Federal Reserve Bank of St. Louis, Industrial Protection Index, FRED Economic Data, https://fred.stlouisfed.org/series/INDPRO; Federal Reserve Bank of St. Louis, Real Gross Domestic Product, FRED Economic Data, https://fred.stlouisfed.org/series/GDPCA (since 1929); Louis Johnston and Samuel H. Williamson, "What Was the U.S. GDP Then?," MeasuringWorth.com, https://www.measuringworth.com/datasets/usgdp/# (pre-1929); U.S. Department of Commerce, "Historical Statistics of the United States, Colonial Times to 1970: Bicentenial Edition," U.S. Census Bureau, 1975, https://www.census.gov/library/publications/1975/compendia/hist_stats_colonial-1970.html.
Note: Money = monetary base; IPI = industrial production index; GDP = real gross domestic product.

children," in education, health care, retirement security, the ecosystem, and myriad other purposes, not all productive. Such a reclassification possibly appeals to traditional proponents of investment, but it works to preserve and expand public consumption at the expense of investment. The GRPF becomes a dead letter regardless of whether it is *rejected fallaciously* as a barbaric relic of a bygone era of fiscal rectitude, or whether it is *endorsed erroneously* on the dubious grounds that most public outlays are now akin to capital outlays that can be predominantly and safely debt financed.

Politicians are not alone in rebranding consumption as investment. In public economics, all types of public outlays have been classified as "capital investment," including outlays on public schools (to create human capital); social insurance (to create safety nets); food stamps or unemployment benefits (to provide countercyclical measures mitigating recessions); the prevention of climate change (to preserve natural resources); bailouts of "systemically important" banks and firms (to prevent financial-economic meltdowns); and sports, recreation, entertainment, and the arts (to provide emotional fuel and local pride). Even spending on war, an obvious act of destruction, might be called an investment if it preserves a nation's autonomy, liberty, or security (the preconditions of prosperity). Such spending also entails operational expenses, which some might say deserve to be capitalized. If so, nearly all public spending can be considered capital spending and legitimately debt financed. The real danger now is not so much that an objective rule like the GRPF is breached, but that classifications of public spending become so subjective that most outlays and debts can be designated GRPF-compliant.

Weak-form defenses of the GRPF today aim less at ensuring that public debt is used only to fund public capital investment and more at ensuring that at least *some* material budget allocation remains for such investment, especially when a large and growing portion of public outlays becomes consumptive and crowds out both public and private investment. The worry was heightened as fiscal-austerity plans proliferated post-2008. Forced to choose, politicians more willingly curtailed capital outlays than transfer outlays; the choice was seen as less risky electorally. If public economists now admit any vestigial value in a GRPF, it is only the GRPF's capacity to ensure that public investment survives fiscal stringency. A GRPF can now "safeguard" public investment, which presumably helps in recovery from recession, embodies "growth-friendly properties," and provides "intergenerational equity." According to an International Monetary Fund report:

> Golden rules impose a ceiling on the overall deficit net of capital expenditure (also called current balance). With a zero ceiling, borrowing is permitted to finance investment only; current spending must be covered by revenues. Golden rules are designed to promote and protect capital expenditure, which is seen as more pro-growth and politically easier to cut than other types of spending. These rules are also more consistent with intergenerational equity than other budget balance rules, since they shift the burden of financing public investment projects from current to future generations, which will be the

> main beneficiaries of such projects. The growth-friendly properties of golden rules should not be overstated.[25]

Similarly, Achim Truger worries that European sovereigns suffering wide budget deficits will face "fiscal constraints" that might "drive member states into austerity" and make things worse.[26] However, he notes:

> The golden rule of public investment . . . is widely accepted in traditional public finance and would allow financing net public investment by government deficits thus promoting intergenerational fairness as well as economic growth. A pragmatic version focusing on net public investment as defined in the national accounts minus military expenditures plus investment grants for the private sector could quickly be implemented. Net public investment should be deducted from the relevant deficit measures of the Stability and Growth Pact and the fiscal compact. Over time it could be technically and statistically refined and potentially include other—more intangible—types of investment like education expenditures. . . . The golden rule would have to be complemented by expansionary fiscal policy to provide the urgently needed boost to the European economy in the short term.[27]

As discussed, much analysis of the GRPF today presumes that public capital investment is either productive, in the sense of being self-sustaining (through fees), value-adding, or helpful (even necessary) to enhancing private-sector productivity. But the presumption is questionable when a capital project is defended primarily as a job creator (not necessarily a wealth creator, given featherbedding and other corruption) or as a spending multiplier. The premise is also questionable to the extent that public capital analysis excludes or underestimates opportunity costs, or the foregone (private) use of resources deployed publicly. Analysis is partial, as it calculates only the potential return on investment of a public outlay or the productivity of existing public capital; to be truly convincing, analysis must prove that a public outlay or asset is *more* productive, over the long run, than the private alternative (if one exists and is genuinely demanded). Even when some public infrastructure proves to be valuable, in isolation it does not prove that the private sector could not be its superior, more profitable builder and operator. Private options are crowded out if infrastructure is deemed an inevitable monopoly, and therefore necessarily a government undertaking.[28] Not only might public infrastructure be productively *inferior* to similar-purpose private versions, but badly built, underbuilt, or undermaintained (yet monopolized) public assets can *impede* private-sector economic growth and productivity. Even public schools may prove so inferior to private alternatives that they generate not positive but negative externalities, as when they waste or destroy potential human capital.

Even if it is valid to assume that public infrastructure is as productive (or more so) than similar-purpose private infrastructure, two potential problems remain: an insufficient amount of it may be built, and large public debts nonetheless may be incurred to fund not investment but consumption.[29] Even productive public capital may be deficient in aggregate and in its power to service public debt.

THE GOLD STANDARD IN MONEY

The GRPF is but one of a few crucially important public finance rules that have been abandoned over the past century. Monetary rules have been similarly abandoned, most notably the international classical gold standard, which was first diluted a century ago, then jettisoned partially in the 1930s and entirely in 1971. The twin abandonment of fiscal and monetary rules in the past century was no coincidence. State control of money via central banking facilitates deficit spending, provides a ready demand for new public debt through debt monetization, artificially lowers borrowing costs, and helps impose implicit inflationary debt defaults. Nor is it coincidental that debt finance has so materially substituted for tax finance in the past century, unlike the prior one.

Table 16.4 makes clear that U.S. federal deficit spending and debt buildups have become the norm since the gold-based dollar was jettisoned in 1971 and have grown much larger relative to the economy's productive prowess in those years. U.S. spending was more restrained, and fiscal discipline was superior, under the previous two (gold-based) monetary regimes. Since 1971, federal spending has averaged 20.0 percent

TABLE 16.4

U.S. spending, budget gap, and debt under three monetary regimes, 1870–2018

Monetary regime/ years	**Spending**	**Surplus–deficit**	**Gross debt**	**% of time with deficit spending**
Classical gold standard/1870–1913	2.5%	0.3%	11.9%	28%
Hybrid gold-fiat system/1914–1970	13.3%	–2.6%	45.7%	64%
Inconvertible fiat system/1971–2018	20.0%	–3.0%	60.1%	94%

Source: U.S. Office of Management and Budget, "Historical Statistics of the U.S.": Table 1.1, https://www.whitehouse.gov/omb/historical-tables/; TreasuryDirect, "Monthly Statement of the Public Debt (MSPD) and Downloadable Files," https://www.treasurydirect.gov/govt/reports/pd/mspd/mspd.htm (Gross debt); Federal Reserve Bank of St. Louis, "Gross Federal Dept,", FRED Economic Data, https://fred.stlouisfed.org/series/FYGFD (Gross debt series since 1939).

of GDP, and deficit spending has occurred 94 percent of the time, causing gross federal debt to average 60.1 percent of GDP. During the hybrid (part-gold-based) monetary system of 1914–1970, spending averaged only 13.3 percent of GDP, while deficit spending occurred just 64 percent of the time, and debt averaged 45.7 percent of GDP. Under the classical gold standard (1870–1913), public spending averaged only 2.5 percent of GDP, and deficit spending occurred only 28 percent of the time, with debt averaging a mere 11.9 percent of GDP.

The U.S. Federal Reserve wasn't fully established until 1914 and thus didn't exist (and wasn't needed) under the automaticity of the classical gold standard regime of 1870–1913. In this period there was minimal federal spending and a negligible resort to federal borrowing; from start to finish, thanks to budget surpluses, the gross federal debt was cut in half. Just as there was no need for central banking in this period because public spending was restrained and largely tax-financed, there was also no need for a byzantine system of fiscal rules, because the fiscal norm was budget balance and the GRPF.

Public finance and central banking now work in tandem—thus politically and unscrupulously. Most major central banks now wield near-complete discretion to conduct monetary policy in any manner they choose, without any material accountability. In recent years they've elected to monetize vast new sums of public debt at artificially low interest rates; in so doing, they have abandoned even the pretense of "independence," which seemed so crucial to securing their credibility in the 1990s.

Closely related to the erosion of fiscal and monetary rules and discipline over the past century, the United States has been transformed politically, from a constitutionally limited liberal republic into a relatively unconstrained illiberal democracy. Chronic deficit spending is inevitable whenever politicians win and keep office by satisfying popular preferences; powerful, free-riding majorities expect their public benefits (via spending) to exceed their public burdens (via taxes)—a profligate fiscal combination that politicians can deliver only when free of fiscal or monetary rules.

The current search (by some) for fixed fiscal rules amid widespread fiscal profligacy is not unlike the search (by others) for fixed monetary rules amid arbitrary central bank policymaking.[30] In each case the search is understandable and commendable, at least to those who prize principle and fiscal or monetary integrity. But such searches will prove futile to the extent that politicians and policymakers prefer and enjoy constitution-free discretion, seconded by an apathetic and nescient democratic citizenry. Once politicians removed the golden monetary handcuffs from central bankers in 1971, they removed as well the incentive for those bankers (and finance ministers) to care much about budgetary balance or fiscal rectitude. We now live in a time of near-unlimited policy discretion in fiscal and monetary affairs alike. In each realm democratic rulers now reign—without rules. That is precisely the form of arbitrary governance that constitutional liberals of yore fought so hard to resist and restrain.

THE GOLDEN RULE IN MORALITY

The erosion of golden norms in both fiscal and monetary matters plausibly reflects a deeper erosion in the golden rule of morality, which holds that ethics should be sufficiently objective and consistent as to be universally applicable and practicable; if so, one should treat others as one wishes to be treated by them in turn. This norm of reciprocal respect undergirds fair dealing interpersonally, nondiscrimination socially, and equal treatment before the law and politically.

Like the erosion of fiscal and monetary rules, the golden rule in ethics also has eroded in recent decades. Ethical norms influence social, legal, political, and ultimately fiscal and monetary norms. If one erodes, so does the other, through a long chain of causation. Without the golden rule in ethics, people feel justified in treating others unequally and disrespectfully, not as ends in themselves but as means to their own exploitative ends. A world bereft of the golden rule is one of people seeking dependency and a free ride. Codified in policy, it's a world of graduated tax rates that punish the rich for the unearned benefit of the nonrich; it's a world of financial repression that artificially reduces the cost of public debt at the expense of holders; it's a world of bailouts for financial miscreants, a world of corrupt rent-sellers, and a world of fiscally irresponsible officials deploying schemes to promote consumption, spread dependency, and bequeath both inferior-quality public assets and excessive debts to voiceless future generations.

The GRPF in fiscal affairs and the gold standard in monetary affairs have not been lost to the world because they were inefficient or impractical; if ever-rising living standards are preferred, few public institutions better help achieve such standards than sound money and sound finance. History is illustrative. The Industrial Revolution and Financial Revolution, which fueled and fostered economic prosperity beginning in the 18th century, were made possible by credible, rational, and sustainable systems of sound money and sound finance, especially as practiced in the UK and the United States.

The GRPF and the gold standard have been lost to the contemporary world not for technical or economic reasons, but for moral, legal, and political reasons: these golden rules were fundamentally incompatible with the vast and rapid expansion in the size, scope, power, and cost of government over the past century, and incompatible also with the concomitant shift to more subjective, less rule-bound, and more discriminatory norms of public spending and finance. In money, discretion has displaced rules of any kind; in fiscal affairs the ability-to-pay principle of taxation has displaced the benefits principle, while transfer spending on the needs of consumption has displaced outlays on the needs of production. An erosion of the golden rule of morality has bred discriminatory public governance, necessitating substantially less-sound and less-stable systems of both public money and public debt.

The erosion of sound public finance and public money reflects a diminution in the justice-oriented benefits principle, which links the value one receives from public goods and services to the price (in taxes or fees) one pays for them. This link is severed by the increasingly dominant ability-to-pay principle, which embodies the socialist adage that contributions—whether in taxes paid or loans made—must come "from each according to his ability," with proceeds sent "to each according to his need." Wealth is forcibly transferred from producers to consumers, with deleterious effects on saving, investment, productivity, and living standards. More confiscatory taxes impose injustices and degrade incentives to produce; if instead public debt is incurred to facilitate transfers, its full servicing is ultimately jeopardized by a successively less-dynamic (because capital-starved) economy.

PROSPECTS FOR A REVIVAL

A feasible restoration of rational norms in fiscal-monetary affairs requires a new appreciation of the benefits of the golden rule in ethics, and beyond that, a recognition that moral rectitude requires the respect and protection of equal individual rights for all before the law. Without credible and lasting political constitutionalism, there cannot be credible and lasting fiscal or monetary constitutionalism. Politically, a golden rule manifests in what James Buchanan and Roger Congleton call a "nondiscriminatory democracy," which is roughly equivalent to a constitutionally limited liberal republic.[31] They revive and defend a "generality" standard whereby constitutions and statutes bar sovereigns from enacting or imposing on the citizenry anything other than general rules applied to (and abided by) all equally.[32]

In the nondiscriminatory, constitutional society, public benefits and burdens must match, as far as possible, a policy that prohibits the exploitation of some by others; no individual or group is forced to suffer net burdens so that others may enjoy net benefits. This principle is embodied in the U.S. Constitution, not only in its Bill of Rights (barring invasions of the liberties of all citizens, equally), but in its "general welfare" clause (preamble), its tax uniformity requirement (Article I, Section 8), its "equal protection" clause (Fourteenth Amendment), and its "guarantee" of a "republican form of government" (Article IV, Section 4). These provisions implicitly preclude not only a welfare state but unconstrained majoritarianism and the type of public governance that serves not the general welfare but specific (individual or subgroup) welfares at the expense of other welfares. The result of such disparate treatment, in modern parlance, is rent-selling, rent-seeking, pressure-group warfare, special-interest legislation, intergenerational inequity, unsound money, unsound finance, and unpayable debts.

Fiscal rules like the GRPF are not likely to be adopted—and if adopted, not faithfully executed—if the majority in a democracy rejects the golden rule; prefers free rides; and politically envies, exploits, or dispossesses economic minorities (including those with high income and large wealth).[33] Nor does that context permit strict monetary rules. Populist politicians will always eschew any rules that are unsupported electorally; but even tenured, elite academic economists today largely oppose fiscal and monetary rules that might constrain public debts and monetization, as they have so well in the past.[34]

A citizenry that favors a government of great size, scope, and power necessarily also favors a government of great cost—to frugality, liberty, and prosperity. If that citizenry also wishes to shirk personal responsibility for the high cost of government, it will oppose institutions and rules that tie rulers' hands. Ultimately, qua subjects, citizens will come to favor *rulers without rules*—that is, rulers substantially free of constitutional, fiscal, and monetary restraints, because free also of moral restraints.

A revival of the GRPF, like that of the gold standard, does not face insurmountable technical barriers; it is possible if a majority of citizens favors constitutionally limited government. This becomes more likely if they reject the dominant ability-to-pay principle in favor of the benefits principle, by which users pay. It also becomes more likely if they adopt the golden rule of morality in place of exploitation, parasitism, and free-loading. Fiscal-monetary rules derive from broader constitutional norms which derive in turn from deeper moral and rights-based norms and codes. No fiscal or monetary rule—even if logically argued, empirically grounded, and prudently executed—can long survive the pressure exerted routinely by an insatiable, resource-hungry sovereign eager to please dependent subjects.

CHAPTER SIXTEEN

1. The GRPF is distinct from the oft-related principle that public budgets should be balanced *over the course of a business cycle*, with deficits incurred during recessions (as revenues decline) and surpluses incurred during expansions (with proceeds used to repay debt). The GRPF pertains to the *use* made of funds (whether for investment or consumption) borrowed publicly at long maturities. Cyclical issues are relevant to the Golden Rule of Public Finance (GRPF) analysis because in recent decades debt-financed consumption, more than infrastructure spending, has become the preferred fiscal prescription for curing recessions; and surpluses are rare, so debts incurred are rarely reduced. The norm of "balance the budget

over the cycle" also has faded. Strict adherence to a GRPF, which forbids deficit spending for ordinary outlays, implies that deficits caused by recessions necessitate spending cuts, tax hikes, or both, typically a pro-cyclical (thus inadvisable) policy mix. The GRPF also is unrelated to the "golden rule of capital accumulation," embedded in models of "steady state" economic growth beginning in the 1950s.

2. For defenders in recent decades, see Harley L. Lutz, *Public Finance*, 4th ed. (New York: Appleton-Century Company, Inc., 1947); James M. Buchanan, *Public Principles of Public Debt*, vol. 2 of *The Collected Works of James M. Buchanan* (Indianapolis, IN: Liberty Fund, 1958); James M. Buchanan, *Public Finance in Democratic Process*, vol. 4 of *The Collected Works of James M. Buchanan* (Indianapolis, IN: Liberty Fund, 1967); James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*, vol. 8 of *The Collected Works of James M. Buchanan* (Indianapolis, IN: Liberty Fund, 1977); Richard E. Wagner, *Deficits, Debt and Democracy: Wrestling with Tragedy on the Commons* (Northampton, MA: Edward Elgar Publishing, 2012); John Merrifield and Barry Poulson, *Restoring America's Fiscal Constitution* (New York: Lexington Books, 2017); and Richard M. Salsman, *The Political Economy of Public Debt: Three Centuries of Theory and Evidence* (Northampton, MA: Edward Elgar Publishing, 2017).

3. See Joseph A. Schumpeter, "Gladstonian Finance," in pt. 3, chap. 2 of *History of Economic Analysis* (Oxford: Oxford University Press, 1954), p. 402–05; and Salsman, *The Political Economy of Public Debt*, pp. 86, 166–67. William Gladstone (1809–1898) was Britain's prime minster or chancellor of the exchequer in two-thirds of all years from 1852 to 1894; he extolled (and practiced) limited government, sound money (the gold standard), sound finance (balanced budgets), and free trade.

4. For a comprehensive survey of fiscal rules in 96 nations, see Victor Lledó et al., "Fiscal Rules at a Glance," International Monetary Fund, March 2017. The survey reveals that in recent decades only six nations adopted anything like a GRPF: Costa Rica (p. 22: since 2001), Germany (p. 32: 1969–2010), Japan (p. 43: 1947–1974), Luxembourg (p. 48: 1990–2003), Malaysia (p. 49: 1959–present), and UK (p. 75: 1997–2008). In none of the six cases was an enforcement mechanism found that might rectify rule breaches.

5. Jonathan Gruber, *Public Finance and Public Policy*, 5th ed. (New York: Worth Publishers, 2016).

6. That citizens should only pay for what they get and get what they pay for, regarding public goods—termed the benefits principle—is another bygone fiscal rule. It has been displaced by "ability to pay," the principle that richer citizens should pay disproportionately more for public goods, in excess of value received, while poorer citizens should receive value from public spending in excess of what they might pay for them (if anything).

7. Significantly, in private-sector transfers to heirs governed by wills, probate courts permit the deceased to transfer positive- but *not* negative-net-worth estates; if private debts are bequeathed, they must be accompanied by assets of equal or greater value. No such protection is afforded future generations that are compelled to service public debts incurred by ancestors; they may receive public assets that are worth less than the debts.

8. See Richard A. Musgrave, *The Theory of Public Finance* (New York and London: McGraw-Hill, 1959). The influential public finance text succinctly captured the theoretical shift in the 20th century, with "The Benefit Approach" (chap. 4) followed by "The Ability-to-Pay Approach" (chap. 5). As a Keynesian social democrat, Musgrave favored the latter principle. The most influential previous public finance text—Lutz, *Public Finance*—defended the benefit principle. Whereas Lutz favored a limited state, Musgrave did not.

9. The U.S. Constitution refers to the public debt, but only to say that Congress has the power to incur it and raise taxes to repay it (Art. I, Sec. 8) and that it is valid regardless of how or when it is incurred (Art. VI).

10. Policymakers are understandably reluctant, amid recessions, to narrow budget deficits by spending restraint and/or tax hikes, so they resist austerity budgets. Yet studies of fiscal consolidation show that while tax hikes make recessions worse, spending restraint does not. See Alberto Alesina and Silvia Ardagna, "Large Changes in Fiscal Policy: Taxes versus Spending," in *Tax Policy and the Economy*, vol. 24, ed. Jeffrey R. Brown (Chicago: University of Chicago Press, 2010); and Jamie Guajardo, Daniel Leigh, and Andrea Pescatori, "Expansionary Austerity: New International Evidence," International Monetary Fund Working Paper no. WP/11/158, July 2011.

11. The Stability and Growth Pact caps the budget deficits and public debts of each of each member state (28 of them) at 3 percent and 60 percent of GDP, respectively. A member state that breaches the caps must take corrective action by an Excessive Deficit Procedure and, failing that, faces fines and economic sanctions. But there is no strict enforcement of the pact. Since 2008 at least a quarter of the members has been perpetually noncompliant. Sweden and Luxembourg are the only member states that have never breached the caps since the pact was formed in 1998.

12. On the many ways John Maynard Keynes and the Keynesians undermined fiscal rectitude, see Buchanan and Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*. Yet Keynes also worried if public debt wasn't used for public investment; see Elba K. Brown-Collier and Bruce E. Collier, "What Keynes Really Said about Deficit Spending," *Journal of Post Keynesian Economics* 17, no. 3 (1995): 341–55.

13. James M. Buchanan, "Fiscal Nihilism and Beyond," chap. 19 in *Public Finance in Democratic Process*, vol. 4 of *The Collected Works of James M. Buchanan* (Indianapolis, IN: Liberty Fund, 1967).

14. See Giuseppe Eusepi and Richard E. Wagner, *Public Debt: An Illusion of Democratic Political Economy* (Northampton, MA: Edward Elgar Publishing, 2018).

15. See Robert J. Barro, "The Ricardian Approach to Budget Deficits," *Journal of Economic Perspectives* 3, no. 2 (1989): 37–54.

16. See James M. Buchanan, "The Ethics of Debt Default," in *Deficits*, ed. James M. Buchanan, Charles K. Rowley, and Robert D. Tollison (Oxford, UK: Basil Blackwell, 1987). See also a tardy but able rebuttal by Giuseppe Eusepi and Geoffrey Brennan, "The Public-Debt Trap," in *The Reason of Rules: Constitutional Political Economy*, vol. 10 of *The Collected Works of James M. Buchanan* (Indianapolis, IN: Liberty Fund, 2002), pp. 104–6.

17. See Jerome Roos, *Why Not Default? The Political Economy of Sovereign Debt* (Princeton, NJ: Princeton University Press, 2019). Roos contends that "the profound transformation of the capitalist world economy over the past four decades has endowed private and official creditors with unprecedented structural power over heavily indebted borrowers, enabling them to impose painful austerity measures and enforce uninterrupted debt service during times of crisis—with devastating social consequences," in the publisher's summary. https://press.princeton.edu/books/hardcover/9780691180106/why-not-default.

18. Office of Management and Budget, "Historical Tables," Table 3.1—Outlays by Superfunction and Function: 1940–2024. Spending on Human Resources includes spending on education, training, employment, social services, health care, income security, Medicare, and Social Security.

19. What I call "the paradox of profligacy"—successively lower sovereign bond yields despite successively higher public leverage in recent decades—is attributable partly to lower inflation and partly to central bank policies that impose near-zero interest rates and "financial repression." See Salsman, *The Political Economy of Public Debt*, pp. 25, 247–53.

20. Office of Management and Budget, "Historical Tables," Table 9.1—Total Investment Outlays for Physical Capital, Research and Development, and Education and Training: 1962–2020.

21. See Federal Reserve Bank of St. Louis, "Shares of Gross Domestic Product: Gross Private Domestic Investment;" See U.S. Bureau of Economic Analysis, "Shares of Gross Domestic Product: Gross Private Domestic Investment," https://fred.stlouisfed.org/series/A007RE1A156NBEA.

22. Federal Reserve Bank of St. Louis, "State and Local Government Gross Investment." See U.S. Bureau of Economic Analysis, "State and Local Government Gross Investment," https://fred.stlouisfed.org/series/SLINV.

23. Federal Reserve Bank of St. Louis, "Business Sector: Real Output Per Hour of All Persons," https://fred.stlouisfed.org/series/OPHPBS; from U.S. Bureau of Labor Statistics, "Business Sector: Real Output Per Hour of All Persons."

24. See Awaworyi Churchill and Siew Ling Yew, "Are Government Transfers Harmful to Economic Growth? A Meta-Analysis," *Economic Modelling* 64, no. C (2017): 270–87. The authors examine the "common perception . . . that government transfers are harmful to economic growth" and find that they are "more detrimental to economic growth in developed countries compared to less-developed countries because such transfers can have a non-monotonic effect on growth. When government transfers are substantial, as they are in developed countries, they tend to reduce growth."

25. Luc Eyraud et al., "How to Select Fiscal Rules: A Primer," International Monetary Fund How-To Notes, March 2018, p. 5.

26. Achim Truger, "Implementing the Golden Rule for Public Investment in Europe: Safeguarding Public Investment and Supporting the Recovery," WWWforEurope, Policy Paper no. 22, March 2015.

27. Truger, "Implementing the Golden Rule for Public Investment in Europe."

28. In truth, little public infrastructure is built without heavy reliance on the private sector for materials, equipment, factories, transportation, architectural-engineering services, and labor; the biggest public roles are in permitting, planning, and funding.

29. Barro (2003) finds that "for given per capita GDP and human capital, [economic] growth depends . . . negatively on the ratio of government consumption to GDP." Robert. J. Barro, "Determinants of Economic Growth in a Panel of Countries," *Annals of Economics and Finance* 4, no. 2 (2003): 231.

30. See Leland B. Yeager, ed., *In Search of a Monetary Constitution* (Cambridge, MA: Harvard University Press, 1962); and Lawrence H. White, Viktor J. Vanberg, and Ekkehard A. Köhler, eds., *Renewing the Search for a Monetary Constitution: Reforming Government's Role in the Monetary System* (Washington: Cato Institute, 2015).

31. James M. Buchanan and Roger D. Congleton, *Politics by Principle, Not Interest: Towards Nondiscriminatory Democracy* (New York: Cambridge University Press, 1998).

32. On the generality standard, see also James M. Buchanan, "Three Amendments: Responsibility, Generality, and Natural Liberty," Cato Unbound, December 4, 2005, https://www.cato-unbound.org/2005/12/04/james-m-buchanan/three-amendments-responsibility-generality-natural-liberty.

33. The normalization of envy and exploitation of "the most advantaged," embodied in John Rawls's theory of justice, is discussed (and heartily endorsed) by Jeffrey Edward Green. See John Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, 1971); Jeffrey Edward Green, "Rawls and the Forgotten Figure of the Most Advantaged: In Defense of Reasonable Envy Toward the Superrich," *American Political Science Review* 107, no. 1 (2013): 123–138.

34. See recent polls of academic "experts" conducted by the University of Chicago's Booth School of Business on the gold standard (IGM Forum Survey, "Gold Standard," January 12, 2012) and a balanced budget amendment (IGM Forum Survey, "Balanced Budget Amendment," November 7, 2017).

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