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The Hidden Deception of Public Debt

The close links between the "Multiple Theory of the Public Household" by Richard Musgrave and Public Debt as the ultimate tax.

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ABSTRACT

This work studies Public Debt from the point of view of the deception it implies for the citizens. Just like what the theories of Richard Musgrave show with regard to taxes ("Multiple Theory of the Public Household"), the issuing of Public Debt hides how the citizens are forced to pay it in different instances and how it becomes into another Tax.

Public Debt always implies economic waste and ultimately poverty. Despite the intensions of politicians (blinded by "Fiscal Illusion") to change the definition of concepts such as inflation, markets and government through political discourse in order to resort to debt without trace, the only thing true is that Public Debt is nothing more than an immorality that promotes ruin among the citizens and perpetual recession for the economy.

Key Words: Public Debt – Richard Musgrave – Fiscal Illusion – Statism – Mises – Hayek

INTRODUCTION

Public Debt has been widely studied from the point of view of its economic impact and analyzed through several models that try to explain and identify its macroeconomic implications. Nevertheless, little is said about its nature and how it implies a deception both for the citizens that are forced to pay it, and to investors that acquire bonds and treasuries as “secure investments”.

In order to analyze how public debt cheats the citizens, it is important also to highlight that it cheats its holders in a similar way. This is so because debt is paid several times both by citizens and investors. When investors acquire public debt as an investment, they pay its market price. That is the *first time* it is paid. In the future *both the citizens and investors* pay taxes in order to make the government available to pay its debt (therefore *investors pay taxes to pay themselves*). But this is not all, since also public debt takes savings that otherwise would have been used in the market in real investments (consequently these investments would have increased capital rates per worker and therefore real incomes and wages), which did not happen since public debt was issued.

In some countries Public Debt is also placed in government agencies such as Social Security (when national institutions “invest” in Public Debt), thus forcing senior citizens to invest the income of their last days in such Bonds. To the last points we must add inflation (since when taxes are not enough to cover the budget deficits, governments tend to use Central Banks and their Treasuries in order to obtain the money they need to cover them). On the other hand, if the government gets in debt with foreign institutions (such as the International Monetary Fund or the World Bank), to the list we must add the macroeconomic distortion (due to an impact in the Exchange and Interest Rates) that will have a negative result for the economy in the short or medium run (Avila, 1989). Public Debt is, therefore, not only pro-cyclical, but also a deception from the time it is issued.

In this work we will analyze how is it possible that Public Debt is seen as a “secure investment” and is considered by almost every economic analyst as a “good” investment, while at the same time it constitutes a deception both for regular citizens and investors.

THE PSYCHOLOGICAL IMPACT OF PUBLIC DEBT

Public Debt is nothing but a Tax that will be collected in the future (although its payment is done, as we have previously said, several times). Since it is a Tax and our main objective is to identify the psychological impact of Public Debt, we should treat it as such and analyze it like any other Tax. In order to do this we will try to focus on the theories of Richard Musgrave (especially his "*Multiple Theory of the Public Household*") (Musgrave and Buchanan, 1999).

Since Colbert, the economic authority in France under King Luis XIV, it was known that taxing citizens was more effective if it was done carefully and without notice. As his famous quote shows, "The art of taxation consists in so plucking a goose as to obtain the largest amount of feathers with the least possible amount of hissing" (Stiglitz, 1993: 3). Musgrave applied this principle in order to create the most efficient Tax System that would collect the biggest amount of taxpayers' money by making use of a psychological deception, thus cheating the citizen.

This deception consists in taxing separately different products with different rates, and also taxing the same people several times by the application of different taxes on different jurisdictions. Therefore if taxes would take a large percentage of the citizen's income it would be impossible for the regular citizen to identify it. For example, if taxes would take 50% of a citizen's income, under this scheme it would be unthinkable for him to recognize it, since only by analyzing the aggregate payment of taxes he would become aware of it. On the other hand, taxing 50% by only one tax would generate a revolution.

Public Debt, as we have shown in the introduction, is paid several times and, since it is also paid by the "investor" (through his other taxes, whether or not the rent of such investment is not taxed), it turns out that the net profits that it generates are lower than it appears[1] . The deceit happens because the taxes that the government collects from investors in order to pay the debt are not deduced from the investment, and therefore its real performance is unknown. Also, Public Debt is a debt that not only current citizens are forced to pay now with their taxes, but also future citizens will. Then, the question is: If Public Debt is such a delusion, how is it possible that this is

[1] This last happens if the owner of the bond is from the country where it was issued.

not denounced by its victims (which are virtually every citizen in every country)? The answer is that, such as Taxes have been growing and deceiving citizens through Musgrave's prescriptions, Public Debt counts with several factors that operate as psychological barriers to identify the deception.

WHAT IS SEEN AND WHAT IS NOT SEEN

Frederic Bastiat's most famous work, "*That Which Is Seen and That Which Is Not Seen*" (Bastiat, 1850: 1). explains economic fallacies by means of illustrating the results of policies that are meant for specific economic sectors in the short run, for the general economy in the long run. Bastiat shows that if the economy is intervened, then unintended consequences will appear that involve negative effects. But what is especially clear in Bastiat´s work is that the disastrous consequences of government intervention are unknown for the citizens since in order to identify its causes one must know economic theory and also see the full picture. Economic consequences of intervention are disguised by political language (Higgs, 1987: 48-52), which blames entrepreneurs or free markets for the failures of its own policy.

Musgrave's theories try to disguise the *total real impact* of taxes on the citizen's income. Nevertheless taxes *are seen*. Although citizens do not identify their full impact, they do know they are taxed. With Public Debt something different happens, because citizens do not identify directly who is paying it. *The existence of Public Debt is the application of Musgrave's theories to its fullest*. Plus, following Musgrave's trend, in order to increase Public Debt it is authorized that not only the Federal Government, but also States (or Provinces) and Cities get in debt (and sometimes also specific Departments). This is the application of the theory of increasing taxes by taxing the same people on different jurisdictions, to increasing Public Debt under the same scheme.

The nature of Public Debt is kept hidden through a defective use of words. The concept of Government is used in public discourse as an existing entity (it is hypostasized) and therefore citizens (as well as most economists) tend to identify that it is actually *the* Government which is getting in debt, and *not them*. Therefore at the eyes of the public it is the Government the one that is paying its debt and not the citizens.

The response of the public towards Public Debt will depend on the kind of concept they have of the Government. If they define the Government as the union of its citizens (therefore "*The Government is us*") it will be more effective (in the sense it will be less irritating for the people) for the Government to get in debt with its own institutions (for example with its own Central Bank through the issuing of Treasury Bonds) because it would be getting in debt "with itself". On the other hand, if the Government is understood as an entity independent of its citizens, then it is more effective to get in debt with foreign institutions (since it will be identified that it is the Government, and not the citizens the one that is in debt).

In this sense the distortion of concepts leads to the unjust idea of income redistribution. Since it is said that *Wealth* (which is taken as a whole through macroeconomic measures) is created by *Society* (which is a hypostasized concept), then the Government authorities (who are the "representatives" of Society and the administrators of Government) allegedly *have the right to dispose of a part of that Wealth in order to distribute it more equally* (i.e. according to their own arbitrary standards). This is justified by the mistaken and false concepts promoted through political discourse. *Public Debt, therefore, is now presented as a tool for income redistribution and Social Justice*.

The main point of this is that the idea of Public Debt turns into an ambiguous concept where the citizens do not identify that it is them, and not the inexistent entity called "The Government", which has a debt that must and will be eventually paid.

FALSE PAYMENT OF PUBLIC DEBT

Another way of hiding Public Debt is to change debt held with foreign institutions for debt with national institutions, especially in Third World countries. Since institutions as the International Monetary Fund or the World Bank have a negative image, Governments tend to change their debt in order to promote the false idea that its debt has been paid, while it has only changed its creditors.

Actually, if the Government defaults its debt with foreign institutions it fails to pay *only* to specific institutions. But if it is in debt with its own institutions (such as Social Security or its

Central Bank), it is defaulting on its own citizens directly (although a default with foreign institutions would be negative for the country as well). But since the citizens do not identify which specific institutions are creditors of the Government (since public discourse and propaganda hide the facts and also the distribution of such debt titles is separated among different institutions and private investors), they tend to conceptualize that the debt has been completely or largely paid. *They do not see that now they and their future children are in debt with themselves.*

PUBLIC DEBT AND INFLATION

When Governments run out of Money to cover their budget deficits, they use their *legal tender laws and monopoly of issuing Money* in order to cover it. The mechanism is that the Treasury issues bonds that later the Central Banks buys, thus giving the Government the paper money it needs in order to pay its former debt (interests included) and also its current expenses. Thus, the debt is paid with inflation that has a direct impact on real wages and incomes.

The way to avoid the public from knowing what is going on is to change the concept of inflation through public discourse (as well as the *teachings* by most economists) through the definition of Inflation as a "*general increase in the price level of goods and services over a period of time*". Therefore this definition *only* applies if there is an increase in the CPI (Consumer Price Index), but not when *any* exogenous expansion of money by a Central Bank is done.

Nevertheless several economists of the Austrian Schools such as Ludwig Von Mises and Friedrich A. von Hayek define inflation as an *exogenous expansion of the money supply*. This is so because always that the money supply is changed, a distortion of relative prices is generated, which in turn change investment preferences and promote bubbles that lead to booms and busts in the economy (Hayek, 1933; and Mises, 1912). Inflation *is* the manipulation of money and credit, *whether or not* there is an increase in the CPI. Therefore Public Debt based on monetary expansion is necessarily inflationary, and therefore it has a disastrous impact on the economy and welfare of the citizens. As Mises explained:

> "*First of all, there is no longer any term available to signify what inflation used to signify. It is impossible to fight an evil which you cannot name. Statesmen and politicians no longer*

have the opportunity to resort to a terminology accepted and understood by the public when they want to describe the financial policy they are opposed to. They must enter into a detailed analysis and description of this policy with full particulars and minute accounts whenever they want to refer to it, and they must repeat this bothersome procedure in every sentence in which they deal with this subject. As you cannot name the policy increasing the quantity of the circulating medium, it goes on luxuriantly.

The second mischief is that those engaged in futile and hopeless attempts to fight the inevitable consequences of inflation — the rise in prices — are masquerading their endeavors as a fight against inflation. While fighting the symptoms, they pretend to fight the root causes of the evil. And because they do not comprehend the causal relation between the increase in money in circulation and credit expansion on the one hand and the rise in prices on the other, they practically make things worse." (Mises, 1952: 79-80).

Countries that do not have a big capital structure tend to have inflation of prices (CPI increase) in the short or medium run because credit and Money expansion flows to the only sector that exists in a relevant size, which is consumption. The distortion in relative prices in those countries tends to impact directly on those that are measured in the basket of goods under study by the institutions that create a CPI.

In this context it is important to add that those economists that present themselves as Keynesian (as well as John Maynard Keynes himself), fall into contradiction when they say that their policies are only effective in non-inflationary economies (in a bust) because monetary expansions *always* have inflationary results, since they always distort relative prices. And an exogenous contraction of the Money supply with the consequent deflation will also lead to a distortion of relative prices and generate malinvestment as well.

Whether inflation will grow into a hyperinflation (Mises, 1912) will depend on the kind of capital structure of the economy and how big is the expansion of the Money supply. But it will always lead to distortions of relative prices and, consequently, to business cycles. Keynes definition of Inflation is, therefore, misleading and allows the Government to debase the currency while at the same time hiding its effects due to a false and deceptive definition of inflation.

Public Debt is, as we have seen, inherently inflationary when is not based on taxes. *Or, to put it differently, it is based on another tax: Inflation*.

THE NON-SEQUITUR OF PUBLIC DEBT GROWTH FOLLOWING THE PATH OF GDP GROWTH RATE

Other economists have proposed that in order to make the debt more "reasonable" with respect to the possibilities of payment, its growth should be attached to the rate of growth of the economy, as if this trend will make it sensible with regard to the future resources that will exist in order to pay it. But this is also a confusion that leads to a deceptive acceptance of an increase in Public Debt.

Since Public Debt is based on Taxes or Inflation (or both), it has negative impacts in the economy and the capital markets. Not only because it is inflationary, and thus pro-cyclical, but also because it takes savings from investment in the areas preferred by the consumers (as identified by the entrepreneurs), to those areas preferred by the bureaucracy. Therefore it implies a waste of resources.

This means that if the Public Debt increase is based on the expectations of a future increase in the GDP and therefore resources for its payment, the very same fact that such Debt was issued means that the functioning of the economy will be less effective than what it would have been without the debt. And of course it could also lead to stagnation of the economy, a recession or in the worst case a depression.

There is *no reason* why to believe that the expected increase in the GDP should be a standard by which to increase Public Debt.

MANIPULATION OF INTEREST RATES AS A THEFT OF PEOPLE´S LIVES

The Austrian School economists teach that interest rates are based on the time preference of consumers (Mises, 1912). Therefore interest rates are the monetary expression of the relation between consumption and the value of time measured with regard to future consumption. If savings expresses in part the value of time, then to manipulate interest rates is to *manipulate the value* that individuals have of time, of their subjective perception of it.

Every exogenous change in the rate of interest has a direct impact on the capital structure through monetary inflation. This means that minutes and hours of people's lives are being taken away from them, since those minutes and hours, which they invested in the saving of present consumption with regard to future consumption (in a subjective temporal projection to the future), is being destroyed through the arbitrary disrupt of the signals that allow the construction of the capital structure of a country (relative prices, and especially the rate of interest), *which is no other thing that the time people invested in their own future*.

Capital is wasted because of malinvestment based on distorted relative prices due to manipulations of interest rates. This happens as a consequence of monetary inflation, that implies the disruption of the means of saving (money), which in turn distorts the concrete expression of the subjective value that individuals have on their time with regard to present and future consumption. This distortion means taking time away from people, and to take their time away is to take away a part of their lives. *Thus, Public Debt implies precisely taking away people's lives*.

DISTORTION OF THE CONCEPTS OF MARKET AND GOVERNMENT

Since one of the known criticisms towards Public Debt is that it necessarily implies a waste of capital due to the displacement of investment funds from capital markets to the Government Treasury, another technique of discourse is used in order to hide the negative effects of this policy. Here the concepts of Market and Government are distorted.

Basically the political discourse focuses in treating the concept of Government as how it should be according to an *ideal standard* and judge the actual Government on this standard, while treating the concept of the Market as how it actually works without taking into account the context (for example if Government intervention *prevents* the Market from functioning properly). This means that whenever a "Market Failure" is identified, the blame is imposed on the Market *as a concept*, while when a failure is identified in the functioning of the Government, it is said that it did not work *as it should*. The difference is that the public tends to believe that Markets are *inherently inefficient although they may work fine sometimes* while the Government is *inherently efficient while it may work badly sometimes*.

This is achieved through the promotion, through political propaganda, of certain definitions and language with regard to specific situations that pertain to the functioning of both the Market and the Government. Primarily the intellectuals are the ones that impose certain ideas on the public, through the Media and other means (mostly universities). Basically there is an *asymmetry* in how both concepts are treated, and how the contexts are distorted in order to make the case of which should be in charge of allocating resources.

With regard to Public Debt, it is said that the opposite of the criticism stated above is true, i.e. precisely *because* the private sector is not working at its best, the Government *should* use those *idle* resources and “invest” in those sectors which are not being developed by the private sector. The source of this deceptive way of identifying the function of Government comes from the arbitrary and false distinction of the concepts of Market and Government as inefficient and efficient, respectively. Precisely because those areas preferred by the bureaucrats are not receiving investments is the consequence that entrepreneurs allocate resources to more profitable areas, which happens *because the price system (as representing consumer preferences) says so*.

THE DISTORTION OF THE CONCEPT OF INVESTMENT

The justification for the existence of Public Debt in order to "invest" is another deception. This is achieved through the distortion of the concept of *Investment*. The definition of such concept implies that it is the allocation of private resources (saving) for production in specific areas in order to profit, guided by the entrepreneurial alertness (Kirzner, 1989). Therefore *"Public Investment" is only Public Spending (*Rothbard, 1962: 1026). Investment implies an analysis of market conditions in order to identify those products that consumers are more willing to buy, and therefore which areas are the most profitable in order to allocate resources for production. It is a careful analysis of costs and benefits and implies economic calculation. The Government does not use resources according to any economic principle; rather it is done through the arbitrary desires of bureaucrats with respect to electoral promises or political opportunism.

Also the incentives are completely different for a private enterprise that gets in debt and for the Government. The private company *is forced* to produce in order to profit and pay back its debts, while the Government *produces nothing* and depends on the taxes paid by those companies and citizens in order to pay its debts. And to this problem (perverse incentives) we must add that Public Works tend to attract corruption and inefficiency at a large scale (especially in Third World countries).

Thus, *Investment is the opposite of the so called Public Investment, financed through Public Debt*.

"FISCAL ILLUSION" AND IMMORALITY

Politicians, once they know they can stick to Public Debt in order to pay their projects, have the illusion that they *can spend what does not exist* (since the Government *does not have those resources nor will necessarily have them*). This is called "Fiscal Illusion" (Buchanan, 1964: 150-163). Current and also future resources are wasted in order to pay for irrelevant projects. Inflation also works as a *hidden default* that increases the illusion.

On the ethical ground, it is immoral (Tempelman, 2007: 446) that current generations *impose* the payment of a debt to future generations while it is the current one that will have the benefits for it. Plus, future generations *did not even vote* for the politicians that put the Government in debt and will still be forced to pay.

THE ROLE OF STATISTICS AS A DECEPTION TOOL

Since economic statistics (especially of macroeconomic measures) deal with billions and trillions of dollars, it turns impossible for the people to grasp their meaning in concrete terms. This implies that such statistics tend to be arbitrary numbers for the citizens, who do not identify any concrete expression of such concepts in reality. Therefore those numbers are not understood. Since people have not conceptualized the meaning of such numbers (they cannot concretize such measures), they do not understand the true meaning of political propositions and discourse dealing with Public Debt. For this reason Public Debt is not shown in *per capita* terms, but as a whole. This is done to hide the relevance and impact of the debt for each citizen.

Also Governments may distort official statistics in order to avoid paying its creditors the true amount they should pay in interest. In certain cases, interests paid by certain Bonds and Titles issued by the Government are to be calculated through specific indexes that follow the official rate of Inflation. Therefore in order to pay less in debt interests, some Governments will be interested in manipulating the CPI. In this case the creditor is cheated by the Government through less revenue for its investment in the Bonds and Titles, and the citizens are cheated through inflationary policies hidden by the manipulation of the CPI (which also hides the real figures of poverty, among others).

This is one of the reasons why some authors, such as Murray Rothbard, have argued that the Government should not compile any statistics whatsoever (for Rothbard the concept of official statistics is dangerous precisely because it gives bureaucrats the guidelines for planning) (Rothbard, 1961).

WHAT TO DO WITH PUBLIC DEBT?

Once we have analyzed the immorality and economic disaster that Public Debt implies, the cause of why Governments fall into such a debt must be recognized: *Unbalanced budgets due to political intensions of extending the scope of Government beyond its basic functions* (i.e. security and justice), such as the promotion of income and wealth redistribution through several programs. These programs entail large expenditures that the Government cannot finance entirely through tax revenues, and since it cannot increase taxes indefinitely it eventually gets in debt and it must sooner or later resort to inflation.

In order to avoid the negative consequences that Public Debt has, it must be shown to the public that it is nothing more than a hoax. In order to fix the unbalanced budgets that generate the appeal to Public Debt it is necessary to clearly state what the real functions of Government are and why spending should be slashed dramatically. Only this way production and employment will grow and lead the economy towards the path of progress. Public Debt is the *ultimate tax*, and as such is *hidden* from the awareness of the citizens through the mechanisms we have seen.

But, in order to make sure that politicians (which are subject to incentives of their own in order to resort to Public Debt) will not appeal to such a deceptive technique for obtaining the resources they want for their plans, the advice of Thomas Jefferson should be followed. As he said in his letter to John Taylor, "*I wish it were possible to obtain a single amendment to our Constitution. I would be willing to depend on that alone for the reduction of the administration of our government to the genuine principles of its Constitution; I mean an additional article, taking from the federal government the power of borrowing*" [2] (Straub, 2012: 26). Nothing more than a constitutional limit will put an end to this large scale fraud known as Public Debt.

[2] Thomas Jefferson letter to John Taylor (26 November 1798).

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