Economists make a category mistake when they treat democratic governments as indebted. A category mistake arises when qualities are assigned to an entity that that entity cannot logically have. Observation of a traffic jam will show it to move backward (Resnick 1994). It would be a category mistake to treat a traffic jam as a gigantic car that moves backward. To the contrary, a traffic jam is an entity that is distinct from the individual cars that constitute the jam. A traffic jam is an emergent entity that supervenes on the cars that constitute the jam, and the traffic jam has different properties from the individual cars that constitute the jam. For instance, the center of the traffic jam moves backwards as time elapses, even though all cars caught in the jam always move forward. Public debt is similarly distinct from personal debt. Indebtedness describes a relationship between two acting entities. Both individuals and monarchs can be indebted to other entities within a society. Democracies, however, cannot be indebted to other entities within the society. There is no entity within that society from which a democratic legislature borrows. To the contrary, democracies are financial intermediaries that bring together people, some willingly and others forcibly. On the one hand, there are people who seek legislative support for programs they favor; on the other hand, there are people who have the means to support those programs but who often would rather not do so and live with lower tax burdens instead. To speak of democratic indebtedness is to employ an ideological language to promote politically expressed desires; such speech is not a scientific language that clarifies the practice of indebtedness within a theory of public finance.

Without doubt, budget deficits and the accumulation of public debt have become commonplace within the world of democratic political economy. When a nation's public debt is divided by the number of its residents, many people will find that their per capita share of public debt exceeds their personal debt. In a now forgotten past, economists often talked of retiring public debt and governments often created what were called "sinking funds" to facilitate this retirement. No longer does one hear talk of establishing sinking funds to help in retiring public debt. All the talk in the early twenty-first century is about "managing" public debt, with such talk reflecting a presumption that public debt is likely to grow in perpetuity. In this respect, the Maastricht Treaty, which established the European Union in 1991, expressly treated public debt as something to be kept within "manageable" limits. Those limits were expressed by asserting that accumulated public debt in member nations should not exceed 60 percent of GDP, nor should a budget deficit exceed 3 percent of GDP in any single year. Yet in the preponderance of EU nations public debt exceeds 60 percent of GDP.

To be sure, no EU nation currently has a budget deficit that exceeds 3 percent of GDP, though several of them are close and most of them do have budget deficits. It seems clear that deficits and debt are normal features of public finance within the EU nations.

It's the same throughout the United States. Among the 50 states, 49 of them have constitutional requirements that they operate with balanced budgets. Yet the preponderance of those states have budget deficits, and most of those deficits exceed the Maastricht limits. Furthermore, David Primo (2007: 109) explains that in 1978, the American federal government enacted the public law named Byrd-Grassley after its two sponsors in the US Senate. That law prohibited budget deficits after 1981; moreover, that law has never been rescinded, but neither has it instructed fiscal practice. That practice at both state and federal levels embraces budget deficits as part of normal budgetary procedure regardless of statutory or constitutional language.

Lexicographers tell us that the meaning of words is determined by how people use them and not by some authority who says how language should be used. Sure, people occasionally consult dictionaries to check meaning and spelling, so the work of the lexicographers can influence linguistic practice. Still, it is mostly individual usage in practical settings that determines linguistic convention, with lexicographers documenting those conventions. Budgetary practice is similar. Budgetary and political practice display intelligible patterns, so that practice can be described by some set of principles or rules that govern that practice. Those principles that practice reflects, however, may bear little connection to what has been enacted in statutes or in constitutions. Furthermore, those principles change through time even without statutory or constitutional change. The sinking funds that were popular in the eighteenth century, for instance, are no longer used even though sinking funds are neither illegal nor unconstitutional.

It is a category mistake to describe democratic governments as being indebted. Individual legislators can be indebted to other individuals or organizations in their personal accounts, just as the monarchs of old could be indebted to wealthy individuals within the society. Democracies, however, are not truly acting entities. A democracy has no independent source of wealth that it can pledge to creditors. A democracy is just an intermediary organization that manages relationships among individual debtors and creditors. What is described as public debt conceals a complex pattern of promises and obligations among people that have emerged through some political process. To describe democracies as being indebted reflects a confusion of thought that, moreover, corrupts some of the moral foundations of liberal democratic regimes as James Odom (2019) notes in explaining how public debt can contribute to the eroding

of principles of justice and public good. This Element examines the confused state of economic theory with respect to public debt. To do this requires an exploration into both the economic theory of public finance and the political philosophy of different forms of government. I start by contrasting the meaning of indebtedness within monarchical and democratic regimes to explain why speaking of democratic governments as being indebted is to commit a category mistake. The rest of the Element probes and amplifies the relevant economic theory and political philosophy, explaining in the process why public debt can undermine the liberal principles that arose when feudal monarchies gave way to liberal republics starting in the eighteenth century, and how the undermining of those principles promoted a new version of the status-based relationships that characterized the old feudalism, which Henry Maine (1861) noted in describing how the replacement of feudal monarchies with liberal republics entailed a shift from status-based relationships to contract-based relationships as a societal default setting. Since the middle of the twentieth century we have been witnessing a resurgence of status-based relationships; growing public indebtedness both reflects and abets that resurgence.

1 Monarchies, Democracies, and Indebtedness

Indebtedness is a relationship between two parties, either persons or organizations, where that relationship fits within the contractual template of promise and obligation (Fried 1981). One party, the debtor, borrows an asset that belongs to the other party, the creditor, and promises to return that asset at some later date in conjunction with supplying the creditor with suitable compensation. What renders that compensation suitable is the creditor's agreement to let the debtor take temporary custody of that asset. Absent duress, a creditor would not give a debtor temporary custody without expecting to receive suitable compensation for granting that custody. To be sure, credit-based relationships do not always work out as the creditor anticipates. The debtor might not return the asset or might return it in damaged condition. Within the private law principles of property and contract, the creditor could pursue a cause of action against the debtor to force the debtor to make good on his promise to the creditor. To have that ability does not guarantee the creditor will be successful in pursuing that action. The debtor might have lost custody of the asset, perhaps because he sold that asset to some unknown buyer and then squandered the proceeds, ending up with no ability to compensate the creditor. Even with a well-working legal system, credit contracts entail some modicum of uncertainty due to events that might transpire in the interval between the initiation of the contract and its conclusion.

The monarchs of old were acting persons, as were the wealthy subjects from whom they sometimes borrowed. Like those subjects, monarchs owned assets and traded on their own accounts. It was a correct use of language to speak of a monarch's indebtedness just as it was accurate to speak of the debt incurred by some of his subjects. Monarchs were enveloped within the same contractual template as were the subjects who lived inside the regime. A significant difference between the monarchical regimes of feudal times and the republican and democratic regimes that replaced them was the abolition of the monarch's personal accounts and their replacement with regime accounts that belonged to no one (Schumpeter 1918). Monarchs owned assets from which they could finance their activities. Indeed, the cameralist writers who arose within the Germanic territories after about 1400 and lasted into the nineteenth century counseled that the princes whom they advised should be able to finance the activities of their regimes by the revenues they could obtain from their forests, mines, and other assets (Tribe 1984; Backhaus and Wagner 1987; Wagner 2012a). Indeed, such cameralists as Justi (1771) claimed that a prince who had to resort to imposing taxes was verging on being a failed prince because well-managed princely property should typically provide princes sufficient revenue to manage their regimes. In this respect, it is notable that around half of state activities within the Germanic lands were financed by prices and fees and not by taxes well into the nineteenth century, in sharp contrast to the public finances to the west where taxation provided more than 90 percent of state revenue (Backhaus and Wagner 1987; Wagner 2012a).

Like an ordinary person, monarchs could sometimes find that their desired expenditures exceeded their liquid assets, and so would seek to borrow to finance those activities. In this desire for loans, a monarch was in the same formal position as an ordinary citizen who sought to borrow from a creditor. As a substantive or practical matter, however, monarchs were not quite like ordinary citizens when it came to credit transactions. Monarchs were instances of what Roger Koppl (2002) calls Big Players. For Koppl, a Big Player is an economic actor who is only incompletely constrained by the ordinary institutional restraints and conventions that govern the market ordering of economic activity. For Koppl, the prime contemporary instances of Big Players are central banks and legislatures. These players are not constrained by ordinary contractual principles. A central bank can create money; it does not have to earn it by supplying services that other people value. It is the same with legislatures, who can make promises to some people without simultaneously imposing liabilities on other people to pay for those promises. While a king incurs obligations to repay creditors just as do ordinary people, the king is not truly an ordinary person. A creditor who did not receive timely payment from an ordinary debtor

could take legal action against the debtor. It would not have been so easy to take legal action against a king.

Still, a king operated inside pretty much the same legal framework as did his subjects. In this respect, the signing of Magna Carta in 1215 sought to place the king on the same legal playing field as the other nobles who would have been his creditors in England at that time. A king could not simply appropriate wealth from subjects but had to convince creditors to lend to him. His status as a Big Player gave him some bargaining leverage, but that is all. Furthermore, kings would typically want to maintain goodwill among their creditors to keep open the possibility of future lines of credit. The creditors of an indebted royal sovereign would rationally harbor some concern about being repaid, but that concern was also limited by recognition that kings typically wanted to maintain a good reputation among their creditors, as a literature on sovereign debt explains and as illustrated, for instance, by Bulow and Rogoff (1988, 1989), Calvo (1988), Cruces and Trebesch (2013), Grossman and Van Huyck (1988), and Tomz (2007).

The coming of republican forms of government in the eighteenth and nineteenth centuries abolished the monarchs and their personal accounts. In many cases, monarchs were retained, mostly for purposes of ceremony and remembrance. But no longer were they rulers of their realms. They were effectively put on pension, the size of which was in principle subject to parliamentary discretion. The budgetary powers were transferred to republican parliaments. A parliament, however, was not a person or a family. It did not have dynastic interests in any reasonable sense of the term. Members of parliament did not come to parliament bringing their assets, which they would deploy in their practice of public finance. Their personal assets remained in their private accounts, and they practiced statecraft by collecting taxes in various ways from the population they governed. It is not a category mistake to describe monarchs as being indebted; it is, however, a category mistake to describe democracies as indebted.

Where monarchical regimes could be reasonably described as entrepreneurial states, republican regimes became tax states. This distinction between entrepreneurial states and tax states was set forth by the Austrian economist Rudolf Goldscheid (1917); and Goldscheid's distinction was contested by another Austrian economist, Josef Schumpeter (1918), with Rudolf Hickel (1976) collecting several essays relative to that controversy. The substantive point of issue between Goldscheid and Schumpeter was how to treat the Austrian debt that Vienna had inherited with the end of World War I and the collapse of the Hapsburg regime. The theoretical point of difference between Goldscheid and Schumpeter concerned different orientations for a theory of public finance. Both

theorists recognized that republican regimes had replaced feudal monarchies, but they differed in the desirability of different institutional arrangements for governing the republican regimes.

Goldscheid thought that a republican regime that relied on taxation would tend to operate in a manner that eroded wealth or slowed its rate of increase, as compared with the monarchies of old. Goldscheid thought that restoring capital accounts to the new regimes would offset that tendency by leading the new regimes to operate in an entrepreneurial manner in much the same way as private persons operated. In contrast, Schumpeter thought that the new regimes would do poorly in trying to act entrepreneurially, and that a tax state where taxes were relatively low would be superior to transferring significant capital assets to political control. The establishment of capital accounts would not induce parliaments into acting like the monarchs of old. More likely, it would induce those parliaments into consuming capital along the lines that Fritz Machlup (1935) later observed.

A short comparison of the public finance theories of Adam Smith and Johan Gottlob von Justi can be informative both regarding the controversy between Goldscheid and Schumpeter and on the differences between monarchical and republican regimes. Given his premier position within the emergence of classical liberalism, the four maxims of taxation that Adam Smith (1776) advanced in Book V of the *Wealth of Nations* are widely regarded as a scheme for limiting the reach of governmental entities into a society's economic activity. Smith's maxims asserted that

1. Taxes should be levied in proportion to property;
2. Taxes should be certain and not arbitrary;
3. Taxes should be convenient to pay;
4. Taxes should be economical to administer for both taxpayers and state.

Compared with the practice of democratic public finance as it has evolved up to the early twenty-first century, the impact of Smith's maxims in limiting a state's collection of revenue seems reasonably clear, particularly with respect to his first maxim that taxes should be levied at a proportional rate, in contrast to the progressive rates that are common today. Smith's maxim didn't say anything about exemption from tax. A tax that is levied at a proportional rate, but which includes substantial exemption from tax, can be highly progressive. A tax of 10 percent on all income (or property) fits the notion of a proportional tax. In contrast, a proportional tax of 10 percent combined with exemption for the first $50,000 can be highly progressive because the average rate of tax paid increases as income rises beyond $50,000.

Justi (1771, pp. 549–65) also articulated maxims of taxation, though these have not been carried forward in the literature on public finance. Justi's maxims included the same territory as Smith's, but they went beyond Smith in limiting the power to tax. For one of those maxims, Justi asserts that a tax should not deprive a taxpayer of necessary items or cause a reduction in capital. Justi further claimed that a tax should neither harm the welfare of taxpayers nor violate their civil liberties. With respect to maxims of taxation, it would seem reasonable to accord Justi similar status to Smith within the pantheon of liberal public finance (Wagner 2012a).

More significantly, Smith and Justi differed in the proper place of taxation within the practice of public finance. For Smith, taxation was the default setting for public finance. Smith preceded his discussion of taxation by arguing that the state should eliminate its holdings of property, thereby eliminating the revenues they derive from those holdings. In contrast, Justi explained that taxation should be a final or last resort option for public finance. Ideally, a state would not tax at all, and would derive its necessary revenues from the sale of services acquired from the operation of its enterprises. Smith and Justi articulated similar maxims regarding qualities of a desirable system of taxation; however, Smith thought taxation should be the primary instrument of public finance, while Justi thought taxation should be an instrument of last resort.

The different attitudes toward taxation that Smith and Justi expressed are relevant for the distinction between monarchical and democratic public finance, as well as for the controversy between Goldscheid and Schumpeter regarding the possible recapitalization of the state after republics had replaced monarchies. Justi treated the state ideally as a participant within the economic order of a society. The state was one participant among many, all of which operated by the same principles of action and rules of law. In contrast, Smith treated the state as operating outside a society's economic order by intervening into it. Where Smith looked to maxims that would limit the negative features of the state's intervention into society, Justi looked to the establishment of institutional arrangements that would render state activity a generally valued participant within a society's economic arrangements.

One need not take sides with respect to Smith and Justi, or to Schumpeter and Goldscheid, to recognize the significance of political presuppositions for a theory of public finance. The habits of thought economists applied to the feudal monarchies were generally extended to the various forms of democratic and republican regimes that replaced those monarchies. Where there had once stood a king, there now stood a parliament. Other than the morphing of a king into a parliament, nothing of theoretical significance for public finance had

changed. The royal sovereign was replaced by a sovereign parliament, with this replacement being without significance for a theory of public finance. In this respect, the noted Swedish economist Knut Wicksell (1896 [1958]) described what he regarded as the sorry state of the theory of public finance at the end of the nineteenth century by lamenting that "the theory of public finance reflects its beginnings when autocracy ruled the west." To counter the prevailing theory, Wicksell sought to articulate some elements of a theory of public finance that would be suitable for democratic regimes.

A monarchy was identified with a person who held the throne, along with the regime having principles of succession for when a monarch dies. Monarchs traded on their own accounts. They had assets that they could use to generate revenue. They had expenses, including the finance of wars. To meet those expenses, they would sometimes borrow from wealthy subjects. All these participants were entangled within a transactional nexus of contract and obligation. Though a monarch was a Big Player inside that nexus, the monarch still needed to maintain that nexus, for its disintegration would probably lead to the regime's disintegration as well.

Habits and conventions of thought that were forged in the presence of monarchical governance were carried over to democratic regimes, as Wicksell recognized in his lamentation. The resulting conceptual error was to equate a parliamentary assembly as formally identical to a monarch despite the obvious descriptive differences between democracies and monarchies. Those descriptive differences were more than matters of mere description; they pointed to deep differences in the operating properties of the different types of regime. The actions of a monarch can be reasonably understood through the economic categories of personal or business choice. The actions of a democratic parliament cannot be so understood, as Wicksell sensed and as the later articulations of the theory of public choice, starting with Kenneth Arrow (1951) and Duncan Black (1958), explained.

Monarchs trade on their own accounts; parliaments do not. Parliaments are forms of financial intermediary, only they operate within an environment where they are largely though not wholly free from competition from other suppliers of similar services. For a national government, a parliament does not face competitive parliaments. It can be different for a federal form of government where a national parliament can face competition from provincial or state parliaments. To be sure, federal governments can also restrict the ability of other governments to compete activities away from the national government, and act instead as entities that cartelize the federal system and which Michael Greve (2012) describes as turning the American constitutional system upside-down by replacing a principle of competition among governments with one of cartelization.

In any case, it is not accurate to describe a democratic parliament as being indebted. The transformation from monarchy to democracy did not transform a monarch into a hydra-headed monarch. Rather, it abolished entirely the position of monarchy, replacing it with a fiscal commons that was managed by a committee whose membership periodically turned over through elections; and Wagner (1992, 2007) and Brubaker (1997) explored public finance from the perspective of a fiscal commons, with Ringa Raudla (2010) amplifying the theory of a fiscal commons. To seek to understand the properties of parliamentary democracy with theoretical concepts and categories fashioned for a monarchy is like trying to understand the properties of a jet aircraft in terms of those of a propeller-driven aircraft. In short, political presuppositions are central to understanding public debt within democratic regimes and for understanding how public debt can corrupt the promise of contract (Wagner 2017b).

2 Political Presuppositions and the Theory of Public Finance

As noted above, the Swedish economist Knut Wicksell (1896 [1958]) lamented what he regarded as the sorry state of the theory of public finance by explaining that

> With some very few exceptions, the whole theory [of public finance] still rests on the now outdated political philosophy of absolutism. The theory seems to have retained the assumptions of its infancy, in the seventeenth and eighteenth centuries, when absolute power ruled almost all Europe . . . Even the most recent manuals on the science of public finance frequently leave the impression . . . of some sort of philosophy of enlightened and benevolent despotism. (Wicksell 1958: 82)

Wicksell's reference to absolutism and to enlightened and benevolent despotism could have fit in varying degrees the mercantilist and cameralist regimes that had disappeared by the nineteenth century. They did not, however, fit the time when Wicksell was writing, which was a time of democratic republics, and democratic republics are still prevalent today.

Public finance is a theory that pertains to the economic organization of political activity. It is the economic theory of state activity, in contrast to the economic theory of market activity. Wicksell raised the challenge of how to think of the economic organization of state activity within a political context of democratic and republican governments, as against the presupposition that governments were absolutist. The key difference between absolutist and democratic regimes is that with absolutist regimes state activity stems from some ruler's choices and actions. With democratic and republican regimes, by

contrast, state activity is not the domain of some ruler but is rather the outcome of some process of interaction among interested participants. The phenomena of public finance in democratic polities emerge from within institutional arrangements that operate through committees and elections (Black 1958) and not through some ruler maximizing his or her utility function.

It is far easier to develop theoretical formulations as if governments are absolutist than it is to recognize them as being democratic. For absolutist regimes, the standard model of choice by consumers or by firms can be used. This setting makes it reasonable to explain state activity as some instance of optimizing choice, which requires only two types of information: an objective function, and a constraint on the ability to maximize that function. A theory of public finance for a democratic polity is vastly more complex because state activity is not reducible to solution of a simple problem in constrained optimization. To the contrary, state activity emerges through interaction among interested participants and, moreover, with that interaction being shaped and constrained by institutional and constitutional rules and principles that speak to the political presuppositions of a theory of public finance. Ringa Raudla (2010) illustrates this point lucidly by explaining the relevance of Elinor Ostrom's (1990) work on the governance of commons settings to public finance, and with Roger Congleton (2011) chronicling the development of parliamentary institutions and practices in the liberal democracies.

To illustrate this point about political presuppositions, I shall compare Wicksell's contemporary Francis Edgeworth (1897) with Wicksell. Edgeworth posed the question of how a ruler should extract the desired volume of revenue from subjects when it is desirable to minimize the utility losses those extractions impose. This question was construed as a simple problem in the calculus of constrained maxima and minima that had entered economics around that time. Edgeworth assumed that subjects received utility from their incomes at a diminishing rate, though they had identical income-utility functions. Within this set of presumptions, despots who were benevolently inclined toward their subjects would extract taxes from the highest incomes where the marginal utility from income was lowest. What resulted was a type of progressive rate schedule where incomes were pared down from the top until the despot had raised the desired amount of revenue.

Edgeworth also recognized that this type of tax schedule would induce people with high incomes to reduce their effort, thereby reducing the income they earn when they are faced with a marginal tax rate of 100 percent. Frank Ramsey (1927) formalized the trade-off between redistributing utilities through taxation and reducing total output, which led later to the creation of a literature on optimal taxation for which James Mirrlees received the Nobel Prize in