2

Public Debt and the Economics of David Ricardo

Political Economy, when the simple principles of it are once understood, is only useful, as it directs Governments to right measures in taxation. We very soon arrive at the knowledge that Agriculture, Commerce, and Manufactures flourish best when left without interference on the part of Government, but the necessity which the state has for money to defray the expences of its functions, imposes on it the obligation to raise taxes, and thus interference becomes absolutely necessary. It is here then that the most perfect knowledge of the science is required.

David Ricardo (12 November 1819), 1951, VIII, p. 133

2.1 Introduction

Ricardo’s analyses of resource allocation and economic growth have been subject to much scholarly debate, which has been outlined in the introductory chapter of this study. And his work on the public debt, neglected relative to other topics he addressed, has not been used to its full advantage to resolve this debate. This chapter examines the relationship between Ricardo’s views on public debt and his economic analysis, to show that each serves to illuminate the other. One cannot fully comprehend Ricardo on public debt unless one recognizes that his position is derived from his analyses of allocation and growth. Likewise, to dismiss his writings and speeches on the public debt as peripheral to the main body of his work is to neglect a rich source of material whereby we can expand our understanding of the nature of his economic analysis.
With respect to public debt, Ricardo made two related policy recommendations: that under no circumstances should government expenditure be financed by means of borrowing, and that effective action should be taken immediately to redeem existing public debt. In Section 2.2, I demonstrate that his opposition to taxation to service the debt, turning on the harmful effects on resource allocation of the vast majority of taxes, is founded directly upon his economic reasoning. I present evidence to the validity of that interpretation of his allocation analysis as sharing many features with neoclassical price theory. In Section 2.3, I address Ricardo's concerns regarding public debt in a growth context. Ricardo shared the worry of many of his predecessors and contemporaries that onerous debt service taxation might drive capital abroad, a consideration that led him to advocate debt redemption. The social benefits of capital growth also legitimized his preference for tax financed government expenditure over public loans. Ricardo's analysis of growth issues thus provides another important source of his views on public borrowing and public debt. It emerges that this analysis makes sense only in the context of a New View-style growth framework, in which the economy was envisioned as experiencing ongoing growth of both capital and population. In Section 2.4, I raise the question of whether Ricardo ever enumerated the features of what he would consider as constituting an optimal tax system.

### 2.2 Public debt and resource allocation

Ricardo's great concern over the harmful consequences of taxation for resource allocation, arising out of his theoretical analysis of tax incidence, served to reinforce his opposition to public debt in a practical context, for fully half of the tax revenue in his day was devoted to debt service. Others, Adam Smith included, expressed fears of capital flight in response to excessive taxation to service the debt; but an emphasis in this context on the allocative consequences of debt service taxation was unique to Ricardo.¹ It was his position that, in levying taxes, ‘The aim of the legislature should . . . be to press on all equally, so as to interfere as little as possible with the natural equilibrium which would have prevailed if no disturbance whatever had been given’ (Letter to Brown [13 October 1819], 1951, VIII, p. 101). The English economy in its existing circumstances was, in Ricardo's