Assets matter just as much as debt

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Crises have always led to intense discussion of the role of the state. The present one should be no exception. The immediate danger has not passed: just look at events in the eurozone. But the time has come to look at the longer-run implications. This is particularly important when one considers fiscal consolidation. On this I make a simple point: it is not just about debt; it must also be about assets.

That the challenge of fiscal consolidation is large is indisputable. The new Economic Outlook from the Organisation for Economic Co-operation and Development argues that "merely to stabilise debt-to-gross domestic product ratios by no later than 2025 requires strengthening the underlying primary balance from the current position by more than 5 per cent of GDP in the OECD area on average. Tightening by more than 8 per cent of GDP is called for in the US and Japan, with the UK, Portugal, Poland, Slovak Republic and Ireland all requiring consolidation of 5 to 7 percentage points of GDP."

It is inescapable, too, that much of the consolidation will – and should – fall on spending. This has now turned out to be unsustainably high, given reductions in potential income.

Yet governments should not sacrifice the future to the pressures of the present. What is the sense of cutting spending today if the result is a poorer country tomorrow? This point turns on its head the refrain that we should at all costs avoid burdening the future with additional debt. We should indeed avoid burdening the future with unproductive debt. Yet productive debt is not a burden, but a blessing.

What then is productive debt? This is a question raised by a thought-provoking **paper by Oxford University's Dieter Helm**, an expert in utility regulation.* The kernel is the idea that all societies possess infrastructure assets, which should be thought of as systems. Transport, energy and water systems are examples. We also have education, health, market, financial, judicial, defence and political systems. The more complex the civilisation, the more complex are its systems.

The creation and development of these assets usually involves the state, as provider, subsidiser or regulator. The reason is that they have "public good" characteristics. Thus, they would tend to be underprovided by competitive markets. Neither in thinking about policy nor in measuring the economy or public finances, do we ask whether we are augmenting or running down such systems. But this is what "sustainability" is all about.

Prof Helm recommends as a guide that we should "guarantee that we will invest to pass on infrastructures at least as good as those we inherited". But, he adds: "To sort out the intergenerational issues it is immediately apparent that we need to account ... for the infrastructure in the broader sense." I agree.

Such accounts would be highly imperfect. But if we did make the effort, the absurdity of slashing public investment or almost all state support for university teaching, as the UK government has done, would be evident, not least when the Treasury can borrow at a real annual interest rate of about 1 per cent. Never can there have been a better time to build up public assets. For some reason, Mr Helm does not seem to see that this is what sensible people would recommend today. I find it hard to understand why he rejects such Keynesianism.

He argues that the UK should shift spending away from consumption towards investment, in the long run. I agree. The world as a whole should do so. Yet, in the short run, with demand below capacity, even borrowing that raises current consumption would be better than leaving resources idle. The fact that some residents (future taxpayers) may then have to pay a little more to other residents (bondholders) is surely a second order issue.

Some insist loudly that one cannot solve a problem caused by too much debt by piling on more debt. But that is wrong. In the US and UK, net debt is close to zero: thus, debt is not a burden on society as a whole, but an obligation of some residents to others. As Nobel-laureate Paul Krugman **points out**, debt matters only because of who the debtors are. If, for example, debtors suffer an unexpected loss in net wealth or are forced suddenly to repay, the impact on the economy is bound to be fiercely contractionary. If the state can borrow, to offset this effect, it should do so. That would not impose an overall burden on a society, since net debt would remain close to zero. If it also raised GDP above what it would otherwise be, that would surely be a very good thing.

Nevertheless, Mr Helm's bigger point is absolutely right. We should think hard about assets. Borrowing is no sin, provided we use the funds to ensure that we bequeath a better infrastructure to the future. But unsustainable consumption needs to be curbed. So stop focusing only on liabilities. Look at the assets, too.

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