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David Hume on Public Credit

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DAVID HUME ON PUBLIC CREDIT

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In his essay *Of Public Credit*, David Hume argues against the institutionalization of public credit. Contrary to what is commonly believed, I claim Hume's analysis of public credit is sound and it is an example of his worst-case thinking. Through textual and contextual analysis, I show for Hume public credit brings catastrophic results because men are knaves, systematically biased, and unlucky. Public credit is an appropriate institution to stimulate the economy only if men are perfect and perfectly predictable. But they are not. For Hume, considering the worst-case rather than the best-case helps prevent potential disasters. Public credit should therefore be avoided.

1. DAVID HUME ON PUBLIC CREDIT

DAVID HUME publishes a critical essay on public credit in 1752. His assault against debt is dramatic: «[E]ither the nation must destroy public credit, or public credit will destroy the nation» (Hume 1752, 360-361). The essay is not well received either by his contemporaries or by ours. «Hume's conviction that national debt could reach the point of subverting the whole fabric of society may be thought of as a blockage in his economic thinking, one that not even [Adam] Smith could quite overcome or [Isaac] de Pinto persuade him to abandon» (Pocock 1985, 139). Could Hume's convictions about public credit be something other than a «blockage in his economic thinking»? Is there a way to make economic sense of what Hume writes?

There are many convincing socio-political explanations for Hume's aversion to public debt, mostly based on war-related arguments, but serious economic interpretations are lacking (see Hont 1993, Kramnick 1968, Laursen and Coolidge 1994, Pocock 1975, Pocock 1985, Vickers 1959). With this paper I propose that Hume's argument against public credit is sound on economic grounds if we think of it as an application of worst-case thinking. Hume is a well-known worst-case theorist (see Crapmpton and Farrant 2008, Farrant and Paganelli 2005, Levy 2002). Applying worst-case theorizing method to Hume's model of public credit may help us see why Hume remains perched on his position despite the swiping criticisms of some of his contemporaries,

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such as Rober Wallace (1969 [1758]) and Isaac de Pinto (1969 [1764]). The criticisms Hume receives are indeed on his results, not on his method. This may also imply that Hume's analysis of public credit shows us that the «blockage in economic thinking» may come from our being more accustomed to thinking in terms of best-case rather than in terms of worst-case. Hume, in his essay on public credit may, therefore, remind us of a different method of analysis – worst-case thinking – which may be useful to us today.

The hypothesis I propose in this paper is that Hume's argument against public credit is dependent on certain starting assumptions. Assuming the best of human nature and of the socio-political environment, public credit can be seen as a way to stimulate the economy and should be endorsed. But by relaxing these best-case assumptions and introducing systematic biases and knavery, or even a simple wave of bad luck, public credit can bring catastrophic results and should be avoided instead. Hume's essay on public credit can be interpreted as teaching that considering the worst-case rather than the best-case may help prevent potential disasters.

The paper develops as follows. In the next section, I present the two different ideas of public debt Hume uses. Public debt is an ancient tool of financing public expenditure. Yet, in antiquity the dominant institution for paying for public expenditure is the treasury room. Debt is an extension of the institution of the treasury room. Debt is to be issued only during emergencies, when the treasury is empty. The institutionalization of public debt comes with the idea that debt is an effective policy tool to stimulate the economy. This idea is relatively recent and it starts to take hold in Hume's time. The following section presents the intellectual context in which Hume works. The tension between ancient and new ways of thinking is present in many areas of inquiry, including, but not limited to, the idea of time and the idea of society. Avoiding disaster, that is worst-case thinking, seems to be more typical of ancient times. Aiming at the best possible results, that is best-case thinking, seems to be more typical of a new and modern approach. If seen in this light, Hume's debate on public credit may become more salient. The next session presents Hume's cost-benefit analysis of the institutionalization of public credit under the assumption that all that can go right does so, the argument common in his day and against which he is making his case. I then examine Hume's analysis of some of the possible effects of public credit being institutionalized, if all that may go wrong does go wrong. The final section of the paper presents some limits of Hume's analysis, as highlighted by some of his contemporaries, whose criticisms may hold today as well. Concluding remarks end the paper.

2. WHAT KIND OF DEBT?

Hume opens his essay on public credit by recognizing that a government has a choice between two ways of financing public expenditure: accumulating riches in a treasury room,¹ as the ancients did, or the more modern method, issuing public debt.² A treasury room is a reserve of money. It preserves societies from possible devastations, such as wars or natural calamities, by providing funds and, therefore, stability when most needed. In Hume's words: «It appears to have been the common practice of antiquity, to make provision, during peace, for the necessities of war, and to hoard up treasures before-hand, as the instruments either of conquest or defence; without trusting to extraordinary impositions, much less to borrowing in times of disorder and confusion» (349). Public debt, in its turn, is issued for two reasons: either because of serious «necessity», as was done in antiquity, or «for promoting commerce and riches», as is done today (352). «Necessity» debt is issued when the treasure is exhausted but funding is still needed to complete something that turns out to be more expensive than originally expected – say, to bring a war to an end. In this sense, «necessity» debt does not significantly differ from the treasury room. «Necessity» debt is an extension of the treasury room. It extends the treasury room when the treasury room is exhausted. Hume therefore juxtaposes the treasury room not with «necessity» debt, but with the other form of public credit, the one issued «for promoting commerce and riches».

The literature often overlooks this difference in the justification of public debt, focusing instead on Hume's condemnation of public debt as a way to finance wars (see, for example, Hont 1993, Pocock 1985, Rotwein 1970). But what Hume sees as paradoxical is the idea that public debt could be thought of as advantageous *independently* of necessity, *independently* of financing wars:

What then shall we say to the new paradox, that public incumbrances, are, of themselves, *advantageous, independent of the necessity of contracting them*; and that any state, even though it were *not pressed by a foreign enemy*, could not possibly have embraced a wiser expedient for promoting commerce and riches, than to create funds, and debts, and taxes, without limitation?

(p. 352; emphasis added)

¹ The nature of the process of accumulation of the public treasure is ambiguous. Hume simply says «they made provisions during peace», without recurring to taxation (HUME 1982 [1752], 349). This could be achieved by a positive balance of trade or by *seignorage*. Given the other economic essays, a positive balance of trade seems more likely than *seignorage*, but Hume does not explicitly specify.

² For a detailed history of public expenditure and its financing see WEBBER and WILDAVSKY 1986. On the progressive institutionalization of public debt in Europe see, also, HAMILTON 1947.

For Hume, therefore, the relevant contrast is between the emergency use of «necessity» debt in times when the treasury room is dry and the issuance of public debt «for promoting commerce and riches». It is this latter debt, the debt meant «for promoting commerce and riches» against which Hume argues, not the «necessity» debt. According to Hume, it is the use of public credit «for promoting commerce and riches» that is dangerous, destructive, and a consequence of human delusion. It is this kind of debt used «for promoting commerce and riches» that needs to be avoided (Steuart 1966 [1767]). See, also, Stettner 1945, Webber and Wildavsky 1986).

3. ANCIENT AND MODERN WAYS

To better clarify the difference between the ancient and the new conception of public credit, I suggest taking seriously the contrast between the ancient and the new ways Hume presents. The ideas of time and of society are two of the many examples where in the 18th century this same tension between ancient and new manifests itself (see, for example, Becker 1974 [1932], Cassirer 1979 [1951], Chartier 1991, Continisio 1994, D'Addio 1992, Fest 1992, Foucault 1994 [1970], Gay 1971 [1954], Gordon 1994, Lovejoy 1982 [1936], Nisbet 1980 [1942], Porter 2000, Singer 1986, Sowell 2002, Venturi 1979, Venturi 1984, Webber and Wildavsky 1986). The ancient and new idea of time and the ancient and new idea of society may help contextualize the problems Hume sees in replacing the ancient practice of public credit linked to a treasury room with the new practice of public credit used independently of necessity.

3.1. *Time*

Time can be either a backward-looking or a forward-looking idea. The ancient idea of time tends to be backward-looking. The ancient Golden Age is in the past.¹ The modern idea of time tends to be forward-looking instead. The new Golden Age is in the future.

Consider, for example, the evolution of the idea of utopia as presented by Joachim Fest (1992). Until the 15th-16th century, utopia is an imaginary model and it is proposed as an ideal no-where. The ancients consider utopia only as a mirror, as a foil. But in 18th-19th century, utopia becomes a project, a realizable model. The perfection of the

¹ The religious connotation of the ancient model strengthens its character. Perfection was in the past, in the Paradise which is now Lost. The Fall of man made perfection impossible on this world. The Better World of after-death is not in this world, but in a different. Time is a corruption of an original pure state of grace (SINGER 1986).

utopia will be realized in time, far away in time maybe, but it will be realized in time. Modern utopias describe the real possibility of intervention on human nature to correct its defects, to create a new and better man for the future. In a sense, the ancients walk backward in time, facing the known past and with their back to the unknown future. The moderns walk with the past at their backs, and future in front of them. With modernity there is not a past Golden Age any longer, but a progressive growth of mankind who will give itself a perfect new Golden Age in the future.

The association of ancient time with backward-looking and worst-case thinking and modern time with forward-looking and best-case thinking is, therefore, noticeable as the ancients tend to be concerned with decay, while moderns tend to be concerned with progress. To the ancients, time is a threat, a curse. Time brings everything into dust. To the moderns, time is a blessing, an opportunity. Time brings improvement for a better future. The ancient art of virtuous politics is the art of avoidance of decay. Only through virtue it was possible to slow down the deterioration caused by the passage of time. The modern political economy is the science of 'the greatest happiness for the greatest number', which will bring more earthly happiness to man. The ancient idea asks: how does man avoid the corruption of time? *I.e.*, how do we avoid disasters? The modern idea asks: how does man better achieve the promises of the progress of time? *I.e.*, how do we achieve the best outcome possible?

The ancient backward-looking model of time and the modern forward-looking model apply to Hume's description of the two uses of public debt. Contracting debts for «necessity» is a kind of backward-looking action. The ancients accumulate riches during peace and lock them up in the public treasure, so they could be used after the war to cope with its damages. If the public treasure is exhausted before the end of the war, debts are contracted. Debts pay for actions started in the past. In this sense, they look back. With «necessity» debts there is no intention to focus on the future, to rationally construct a better tomorrow, to better the economy, or to interfere with it. Such debts are simply an emergency payment of an expense incurred in the past and accidentally continuing in the present. On the other hand, the new public credit used «for promoting commerce and riches» is conceived as a stimulus to the economy, which is a forward-looking action. Issuing more debt today brings economic expansion tomorrow as, for example, Hume's contemporary, Sir James Steuart (1966 [1767]) enthusiastically claims (Stettner 1945). This new debt has an implicit idea of improvement, of progress, of looking ahead, that the ancient idea of debt does not have.

3.2. Society

In the 18th century there are at least two competing models of society: a non-perfectible model of society and a perfectible model of society.

The starting point of ancient models of society is a naturally social man. Man cannot be eradicated from society nor can he create society. But, with his imperfections, man can deteriorate society. The *prince* is 'the keeper of the order'. His goal is to keep – *i.e.*, to preserve – the social order, not to improve it, which would prove impossible. A symptom of this change can be seen in modern elections. Modern elections are generally held every 4 or 5 years as a sort of check for the achievements of who is in charge of governing. There were elections in ancient times as well. Nevertheless, in antiquity, terms were generally from about 2 months to 1 year. Elections were held to rotate, to limit the power of whoever was in charge, to put a check on the decay that power could generate.

With modernity, mankind is no longer concerned about the decay of time, but instead sees human limits as challenges to overcome.¹ The modern man discovers his individuality. He begins to question his origins and the origins of society. While the ancient man could not live without society, for the modern man society is the result of a rational choice because it is better to live within society than without it. If the new rational man can modify his environment, he could control and direct his destiny toward a better world. By concentrating on what he can do and on how he can do it best, the modern man begins focusing on his best scenarios. And «promoting commerce and riches» with public debt becomes not only feasible, but also «wise».

Hume does not believe in a rationally constructed society. Progress is in large part an accident of history, or something outside the limited and imperfect human capabilities (Berry 2007 and 2011, Cohen 2005, Danford 1990, Gill 2006). Using public debt as a way to consciously manufacture a better society is not only wasteful, but also dangerous.

3.3. *If all goes well...*

Hume seems to analyze public credit juxtaposing the ancient way of asking how to avoid the worst, assuming mankind is not perfectible, with the new way of asking how to achieve the best possible outcome,

¹ «The chief reason why modern man has become so unwilling to admit that the constitutional limitation of his knowledge forms a permanent barrier to the possibility of a rational construction of the whole society is his unbounded confidence in the power of science. We hear so much about the rapid advance of scientific knowledge that we have to come to feel that all mere limitations of knowledge are soon bound to disappear.» (HAYEK 1983, 15)

assuming mankind is perfectible. The new way assumes that mankind is composed of well-intentioned, public-spirited individuals, unbiased in their judgments. The ancient way assumes mankind is composed of self-interested knaves with systematic biases.

The first analysis that Hume offers is the one with the best possible assumptions about mankind, the one that is popular at the time of his writing. Under the best possible assumption, what can happen if debt is issued? There is an explosion of the population in the capital, which «renders the people factious . . . and even perhaps rebellious» but, at the same time, this tendency is counter-balanced by increased support for whatever kind of government exists, as long as it is stable (pp. 354-355). Public credit would also increase the overall quantity of money in a country, causing price inflation,¹ and, due to international equilibrating forces, it would send 'real money' (gold and silver) abroad. Taxes would increase as well, which is to say that the cost of labor increases, and, as a consequence, the poor are worse off (p. 355). In addition to that, a country may become dependant on foreigners because national debt will be held by foreigners, and it may promote inactivity, offering enrichment without work (p. 355). On the other hand, under the best assumptions about human nature, public credit provides merchants with a «species of money» that somehow «grows» (p. 353). Offering an alternative income to merchants means they can decrease their prices, Hume claims. Decreasing prices means consumption increases, and the economy expands. Moreover, investing in public debt allows merchants to remain in business, while the alternative investment in land would lead the merchants to abandon their activity to retire in the country, taking care of their estates (pp. 353-354). Overall, the benefits of issuing debt outweigh the costs because increasing public debt stimulates the economy. Public debt is therefore good *independently* of fiscal «necessity». The public treasure, or the ancient idea of debt, does not have this major benefit. The public treasure is not there to stimulate the economy. This is not its function or within its ability. Hume explains the new technique of mortgaging the revenue therefore seems «wise», since it is believed to promote «commerce and riches».

¹ The specific mechanisms through which an expansion of public credit would increase the overall quantity of paper money are not specified. We can infer the following process: the government issued more debts, a government sponsored bank issued paper bank notes in exchange for the debt, the paper notes would be redeemable in gold and/or silver at a certain date in the future, when taxes were collected. Issuing debt translates into an injection of money in the economy and public debt into a form of paper money. This allowed generalizing Hume's critique of public credit into a critique of paper money. *On Public Credit* was indeed used Europe-wide as one of the most powerful weapons against paper money (on the debate on paper money see DUTOT 1974 [1739], MELON 1983 [1734] among his contemporaries, and ALBERTONE 1992 for a present-day overview of that time).

Under ideal conditions, public debt used «for promoting commerce and riches» is a more preferred option than a treasury room and its «necessity» debt. Additionally, the ancient way can be problematic in times of peace. During peace, the treasure may be more subject to abuses than mortgaging revenue. Furthermore, having a public treasure has higher production costs, since issuing more debt is cheaper than accumulating more gold either via a more positive balance of trade, taxation, war-plunder, or mining.

Yet, Hume says that the shift from the old method to the new method is «paradoxical». The substitution of the ancient way of conceiving and using public debt for the modern one would not be paradoxical, if man always faces best-case-scenarios. But Hume, as he often does, sets up a straw-argument to then mercilessly take it down. From this point on in the essay, in fact, Hume changes his framework. He tells us the apparent wisdom of using debt «for promoting commerce and riches» is not real, it is a paradox. He does it by asking: what if men cannot achieve ideal conditions? What if men are neither perfect nor perfectible?

3.4. *But what if...?*

I suggest that for Hume, using public incumbencies to promote commerce is dangerous because it is based on best-case assumptions about human beings that are actually not observed in reality.

If men do not live in a perfect or perfectible world, if we do not have best-case conditions, public credit has overwhelmingly higher costs than benefits, and its use brings disasters and misery. The costs are so much greater than the benefits that the benefits look frivolous, such that «you will find no comparison between the ill and the good which result from them» (p. 354). It does not require a genius to recognize it, says Hume, just «a moderate share of prudence» (p. 360). Actually, it is so obvious that not even «the most careless observer» would miss how ruinous public debt is for man (p. 357). Hume is confident that human perfection is impossible, and therefore that public debt would have destructive consequences.

Hume appears to test his hypothesis about the dangers of public debt against a series of hypothetical non-ideal scenarios. Hume asks: what if there is a war instead of the ideal peace? Not only would the treasure avoid disasters, but mortgaging the revenue would surely cause them (p. 351). Or, say that all revenues are mortgaged, and there is an unpredicted increase in expenditure? More revenues have to be mortgaged. This means that more taxes have to be levied, the consequences of which, beginning with the poor, are «ruinous and destructive» (p. 356). The economy is negatively affected as well because with our limited

knowledge of the future we cannot foresee the unintended damages that some taxes impose on businesses (p. 358).

An example alien to the modern reader follows. We do not have a *status system* anymore, but the health of a *status system* is a serious preoccupation in Hume's time, especially among the British Tories.¹ Hume claims that public credit is going to destroy all the differences in ranks.² And without a formal system of social rank there is no cushion between the prince and his people. It had been believed in prior centuries that the nobility was an intermediary between the prince and the people as well as a power to keep the prince within his limits. If there is no nobility, if the prince is not necessarily public-spirited, the prince becomes a tyrant, and there is nothing to stop him. Not even elections will help, since they will be corrupted and controlled (p. 385).

Hume's worst-case thinking continues, in what came to inspire modern Public Choice analysis (Levy 2002). What if politicians are not genuine public servants? What if they have private agendas? If so, credit will inevitably be abused because the short-term interests of the politicians will prevail over the long-term interests of the country (p. 352). And what if, due to circumstances, politicians have what today we would call the 'temptation to cheat' (p. 385)? Furthermore, what if ministers/politicians are not perfect and perfectly benevolent people? Not even by using «the most sanguine imagination» would it make sense to assume that all will go well in fiscal policy (p. 360). And if someone believes that some popular interests may prevail, he should think again. There are stronger interests at stake (pp. 364-365).

With this narrative, Hume seems to reveal the importance of questioning ideal conditions and their use to describe (or prescribe) reality. If, under ideal conditions, the benefits of using debt to stimulate the economy are greater than its costs, it does not follow that the same is true under non-ideal conditions. If the ideal conditions do not hold, as they may very well not, the consequences are devastating. Among the easily foreseeable consequences, Hume warns that the country with public debt «sinks into a state of languor, inactivity, and impotence» (p. 360), because the incentives to work are taken away by increased taxes. «[T]he whole income of every individual in the state must lie entirely at the mercy of the sovereign» (p. 359), because he may need to keep increasing taxes, causing the most ferocious despotism to take place (p. 359). Hume claims

¹ On Hume's association with the Bolingbroke Circle because of the opposition to Walpole's policy of promotion and expansion of public debt see in particular KRAMNICK 1968 and POCOCK 1985.

² VANDERLINT 1970 [1734] had similar worries. Hume's prediction turned out to be correct: the *status system* disappeared soon after Hume's time, even if not because of paper-credit alone.

that the list of «monstrosities» cannot be completed because most of them are not even foreseeable (p. 360). The ruin of so many people will be devastating as well as inevitable (pp. 362-363).

Hume's prediction is clear: «[E]ither the nation must destroy public credit, or public credit will destroy the nation» (pp. 360-361). But despite this, Hume believes that public debt will nevertheless prevail in the future. Hume argues that the ideal conditions under which public debt as a means to stimulate the economy developed could not hold in human reality. But, he also does not delude himself into expecting the extermination of public credit. Public credit will persist, regardless of its failures, because the idea of the perfectibility of mankind and the idea of being able to control and ameliorate suffering in the world are too strong to be resisted (p. 363).

3.5. *But how bad is the worst-case?*

Many of Hume's contemporaries think Hume's argument is deficient in at least two ways. Hume does not recognize that public debt is institutionalized with the realization that we can grow out of it. Additionally, public debt becomes a regular institution when an economy is strong enough to be credit-worthy.

Hume claims that debt will destroy England. Did it? Hume's adversaries ask. Hume's prediction is falsified by facts.

Diogenes, to prove the reality of motion against the sophistry of Zeno, got up and walked. We need only follow the history of facts, to refute by experience every thing that has been said concerning the national debt, since the beginning of the present century (De Pinto 1969 [1764], 103).

Those who disagree with Hume have two major reasons to do so. First, in Hume's days neither England, nor Holland for that matter, despite their debts, were close to an economic collapse. Credit indeed is a consequence of the wealth of a country (Montesquieu 1748). Credit is a consequence of the abundance and of the development of trade; the ancient people did not use public credit to stimulate the economy, because their commerce was limited compared to the moderns (Wallace 1969 [1758]). The disastrous consequences of adopting best-case thinking may be outgrown through the miraculous benefits that public credit allows. There is indeed the real possibility of growing the debt away (De Pinto 1969 [1764], in particular the translator's preface).

Second, neither England nor Holland is close to tyranny. While Hume claims that public debt irredeemably jeopardized freedom, the countries that issue more debt are the freer, both by domestic and by foreigner standards. Robert Wallace explains:

When a free government is able to contract great debts by borrowing from its subjects, this is a certain sign, that it has gained the confidence of the people.

(Wallace 1969 [1758], 53)

And De Pinto confirms:

[E]very thing is done with the sanction of parliament; so that the whole nation may be said to have concurred in creating these annuities, and to have become guarantee and security for the interest.

(De Pinto 1969 [1764], 15)

For De Pinto, the increase in public debt is a symptom of decreased tyranny and an increased trust of the government. De Pinto seems to view the government in the more modern form of representative power of the parliament. Both Montesquieu (1989 [1748]) and Ferdinando Galiani (1977 [1750]) argued that public debt (or paper-credit) was more appropriate for a republic than for a monarchy. Yet, Hume's fears seem not to distinguish among different forms of government and considers it as applicable to all forms of government.

Reconciling Hume's theory with practice was, and still is, an unsolved problem if one looks at the successful cases. Hume may have underestimated the benefits derived from increasing confidence in the power of man, so while the cost estimations are accurate, the newly calculated benefits outweigh them. Hume may have been guilty of the sin that De Pinto accused him of: «Though we may be assured that death will come, let us not kill ourselves for fear of dying» (De Pinto 1969 [1764], 106). Or, maybe Hume was visualizing a scenario in which the ideal conditions are questioned; where uncomfortable hypotheses are brought to light rather than being shoved under the bed. Many countries experience the benefits of public debt. However, many countries also experience the devastating effects of abuses of public credit; are even brought to their knees by it; and in some circumstances the tyranny of the sovereign (ab)using public debt is real tyranny.

CONCLUSION

Public debt was not always a regular institution in public finance. David Hume seems to reject the institutionalization of public credit with what today we call worst-case analysis. In his essay *Of Public Credit*, Hume seems to suggest that public credit is an appropriate institution if men are perfect and perfectly predictable. However, if men are imperfect and the future is unknowable, then the institutionalization of public credit can bring catastrophic results. Hume's criticism of public credit can be

read as a warning that focusing on the positive consequences achievable only under a particular set of circumstances means forgoing the opportunity to focus on how to avoid catastrophic results when those ideal circumstances are not present. Hume may be teaching us a lesson that is difficult to follow in good times but which starts to make more sense when times are not so ideal.

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