

In the forthcoming budget, [the net operating balance](#) will be reported alongside the underlying cash balance.

This change has important policy implications because it creates a strong bias towards public spending on infrastructure and other physical capital assets over public spending on public goods (like health and education) and social welfare.

This might sound quite sensible, if it wasn't for the fact that what the government tends to regard as unproductive expenditure is instead crucial to deliver social welfare, equality, and ultimately long-term growth.

The net operating balance is an accrual measure calculated as revenues minus expenses, capital and revaluation adjustments. This means that capital outlays (i.e. public investment in infrastructure) are not included. Hence the net operating balance is generally higher than the fiscal or cash balances.

By giving greater emphasis to an accrual measure, the government aligns with international accounting standards. This should indeed enhance transparency and support better management of public finances.

However, the economic philosophy that underpins this change is that there is productive and unproductive spending and the government is prepared to borrow only to finance the former.

Good debt, bad debt, and the golden rule

[Treasurer Scott Morrison](#) has indicated that the purpose of introducing the net operating balance in the budget is to make a distinction between “good” and “bad” debt.

In his view, good debt is borrowing to finance public investment in infrastructure and other physical assets that increase productivity and growth. Conversely, borrowing to pay for

everyday expenses is bad debt.

Since the net operating balance does not include capital outlays, it is a measure that will not deteriorate when more and more money is spent on new infrastructure. The government can fast-track its [A\\$50 billion infrastructure plan](#) without contradicting its “fiscal repair” rhetoric.

The view of the treasurer goes back to the so-called [golden rule of public finance](#). This states that government borrowing should not exceed net government capital formation. Capital formation is essentially government expenditure on infrastructure and physical assets.

The golden rule therefore implies that the government should only borrow to build new infrastructure or other forms of physical capital. All other expenses should be financed out of current revenues.

This only makes sense if you believe in two things. One is that economic growth is mostly driven by physical capital accumulation. The other is that there are trickle down effects by which growth results in higher wages, less unemployment and better economic outcomes for the individuals at the bottom end of income distribution.

And that's where problems start.

Glitter is not always gold(en)

There are several issues with the golden rule.

Not all public infrastructure projects increases [growth](#). Infrastructure can be built for purely political reasons, for instance, which would not generate any significant return in terms of increased productivity or growth. This means that public investment in infrastructure is not always good debt.

Highlighting 'good and bad' debt will make it harder to fund social programs

Written by The Conversation

The golden rule introduces a bias towards public spending on infrastructure and other physical capital assets. If unchecked by some other fiscal rule, this bias could cause excessive public infrastructure spending and crowd out private investment in infrastructure. So the economy could end up with less total spending on infrastructure and a large stock of not-so-good-debt.

Growth is not just driven by physical capital accumulation. For instance, an educated workforce [is at least equally important](#). But this is mostly produced through current expenditure, so it should be regarded as bad debt.

In fact, the paradox of the golden rule is that a new road is good debt, but maintaining that road is not; building a school is good debt, but training teachers is not.

Other public goods, like health and social welfare, are also mostly provided through current expenditure. Under the golden rule, the government should pay for them only out of current revenues. But in an economic downturn or recession, current revenues decline. Therefore, in an economic downturn and under the golden rule, the amount of public goods and social welfare that the government provides would also decline. Right at the time when more public goods and social welfare would be needed.

Finally, under the golden rule the ability of the government to address the problem of inequality (a [rising concern in Australia](#)) would be constrained by its ability to raise taxes.

But the Coalition has also been proposing to cut taxes, at least for [corporates and businesses](#). These tax cuts will likely reduce revenues and narrow the policy space to address inequality.

More changes to debt reporting

The treasurer [has said](#) there will be further changes in the way debt is reported on budget night.

Here are my suggestions for what should change:

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Introduce a “sustainable investment” rule of the type [similar to one adopted in the UK](#) . This rule would prevent overspending on public infrastructure.

Adopt a broader view of what constitutes good debt. That is, use a definition that does not reduce good debt to just investment in new infrastructure.

Design mechanisms to account for the cyclical fluctuations of the economy. This could take the form of a modified golden rule that allows the government to run into deficit for certain types of current expenditure (that is, welfare and public goods) in a time of economic downturn.

This would help the recovery of the economy and provide some welfare protections to those who are most affected by the downturn.

Fabrizio Carmignani receives funding from the Australian Research Council for a project on the estimation of the piecewise linear continuous model and its macroeconomic applications.

Read more <http://theconversation.com/highlighting-good-and-bad-debt-will-make-it-harder-to-fund-social-programs-76996>