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The Golden Rule & Fiscal Responsibility

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The golden rule of public finance is a time-honored fiscal policy principle that says that governments should only use debt for capital expenditure and not to fund current operations. I've always been a supporter of the rule. This makes me concerned to see that – with governments under intense budgetary pressure – there are increasing efforts to distort the golden rule to justify fiscal irresponsibility.

Canada provides a recent example of this. The 2025 Canadian federal budget announced a new “capital budgeting framework” which unacceptably stretches the definition of government capital spending (“investment”) for which borrowing may be used. Subsidies of private investment are under this framework deemed to be government investment expenditure, as is depreciation on existing government assets. The Canadian [Parliamentary Budget Office](#) and [independent analysts](#) have spoken out against this “overly expansive” definition of capital spending that “exceeds international practice.”

The Canadian trick is a new version of an old form of abuse of the golden rule: the mislabelling of categories of current expenditure as “investment” to justify financing them with debt¹.

Another familiar distortion of the golden rule is the claim that it justifies more debt for investment purposes *irrespective of the pre-existing level of government debt*. This amounts to arguing that, if you are applying the golden rule, you don't have to worry about fiscal sustainability. But the golden rule is not a rule intended to guarantee fiscal sustainability. After all, a requirement that debt be used only for capital expenditure does not prevent the accumulation of unsustainable levels of debt. This is why, historically, governments that adhered to the golden rule combined it with a debt limit – the United Kingdom being a typical example².

There have always been people who fail to understand this and believe that fiscal policy should be guided exclusively by the golden rule without any accompanying debt limit. Recently, however, this unfortunate notion has been enjoying a new wave of popularity in the form of the “net worth proposition.” This proposition – which I have critiqued in detail [elsewhere](#) – holds that governments should drop any debt rules or targets and replace them with a rule requiring only that they maintain net worth. This is essentially equivalent to the golden rule with no constraints on debt, because it would:

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- Remove any limits on debt-financed capital expenditure (because the assets created by capital expenditure typically offset the debt used to fund them, leaving net worth unchanged).
- Ban debt financing of current expenditure (because, given that current expenditure does not create assets, it necessarily reduces net worth other things being equal).

The view that it is acceptable for governments to take on any amount of additional debt as long as they use it for investment purposes is profoundly misguided. If government debt is already too high, increasing it further will in general make the fiscal position more dangerous even if the funds are spent on investment.

The golden rule should be subject to the proviso that it is only applicable when government debt is at a fiscally sustainable level. This means, sadly, that the rule does not provide a rationale for additional borrowing when, as is the case today in most developed countries, public debt is already too high.

The Golden Rule of Public Finance

The golden rule requires the current costs of government to be entirely covered by revenues, with borrowing confined to the financing of capital expenditure. The rule's main rationales are *intergenerational equity* and *tax smoothing*. Capital expenditure creates assets that generate benefits running years into the future, and intergenerational equity is considered to justify spreading their costs between taxpayers in different future time periods rather than requiring them to be fully financed up-front³. This is achieved by borrowing to finance the construction or acquisition of the asset and then repaying the debt over the lifetime of the asset at a pace that reflects the flow of benefits the asset delivers to citizens. "Tax smoothing" is shorthand for the way in which spreading the tax burden over time avoids the major fluctuations in tax rates which full up-front tax financing would require when the total amount of capital expenditure varies significantly from one year to another.

Fiscal stabilization policy justifies temporary departures from the rule. The golden rule should therefore be understood as a principle to be respected over time, with operating deficits offset by operating surpluses.

In fiscal accounting, the golden rule is best expressed in accrual accounting terms, as a requirement that all *expenses* be covered by revenues – or, equivalently, that the accrual *operating balance* is zero. This is because accrual expenses measure operating costs – the costs of resources used in running government. Depreciation on existing assets is an expense, and measures the costs of using those assets. Capital expenditure, on the other hand, is not an expense. Requiring a balanced budget in accrual terms therefore allows capital expenditure to be funded by debt while requiring depreciation to be covered by revenue, with the depreciation charge used to repay the debt assumed on the relevant assets. This ensures, at least in principle, that the timing of taxpayer financing of capital assets is aligned with their use of those assets, rather than their creation, thereby delivering an approximation of intergenerational equity.

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1. This misguided approach has often been used to justify classifying as investment any human capital expenditure. The golden rule does not, however, justify the accumulation of government debt to fund the creation of assets owned by private agents, be they non-financial assets or human capital. It only applies to government-owned assets. I plan to discuss the reasons for this in a future blog piece. ↩
 2. The UK applied the golden rule between 1997 and the global financial crisis, [accompanying it with a debt limit](#). The golden rule was, appropriately, expressed as a requirement for a balanced budget in accrual operating balance terms. The debt limit was referred to as the "sustainable investment rule," which made it clear that it was intended to ensure that the accumulation of debt to fund capital spending was kept to fiscally sustainable levels. The present UK government has set fiscal rules that essentially aim to progressively move back to this approach, by eliminating the accrual deficit while respecting a debt limit which has now been reformulated using an appropriately broader measure of public sector debt. ↩
 3. The golden rule provides only an approximation of intergenerational equity in the funding of public expenditures. But is it a *practical* approximation (by contrast to alternatives, such as basing fiscal policy on [generational accounting](#), which are too complex and are too sensitive to discretionary assumptions to be able to be used as the basis for fiscal rules). ↩

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