Runaway increases in public debt can occur for two reasons. The first is that the government recurrently spends more on goods, services and transfer payments than it receives in tax revenue. Although the binge is unsustainable, it has the positive results that ought to flow from the expenditure on goods, services and transfer payments. It might be unwise, but the excess expenditure ought temporarily to spread a little fun.

The second is that interest on the public debt explodes. It emerges as a major item in public expenditure and indeed becomes a monster with a life of its own. One year’s budget deficit adds to the public debt which increases next year’s debt interest payments. Those higher interest payments enlarge next year’s budget deficit. This in turn adds more to the public debt which raises the following year’s debt interest payments.

Here the excess expenditure at no stage spreads any fun. Instead, the state has the unenviable task of raising taxes to make a show of honouring its debts, while the citizens have the disagreeable obligation of both to pay higher taxes and to save at least part of their income in government securities of uncertain future value. The uncertainty about the securities’ future value arises because, by hook or by crook, spendthrift governments find ways not to repay in full what they have borrowed. The historical record—examined in Carmen Reinhart’s and Kenneth Rogoff’s This Time is Different (Princeton, 2009)—shows that governments find ways to cheat on the bondholders. They tax them more heavily or create an inflation that reduces the value of the debt in real terms.

Debt interest becomes a monster when the resulting loss of trust is so severe that potential investors in government debt demand a large jump in real interest rates. They demand the extra return to compensate them for the risk of possible future depletions. The change in real interest rates makes the deficits and the debt yet more difficult to sustain. It increases the debt interest charge today. Even worse, unless the government can somehow cut non-interest expenditure or extract more taxes, the increase in the real interest rate accelerates the growth of debt in future.

Attempts to raise taxes on so-called “unearned income”, such as the income paid to bondholders, are unavailing because the bondholders retaliate by refusing to buy new debt except at even higher real interest rates. In the extreme, the government is forced into swinging cuts on hospitals and schools, slashing the pay of teachers and civil servants, in order to keep on servicing and rolling over its debt. The scary dynamics of the public debt tell the politicians what they must do rather than the other way round. To quote the words that Mary Shelley gave to her monster: “You are my creator, but I am your master—obey.”

If all this sounds hysterical, look at the plight of Greece and Ireland. Greece’s public debt is heading towards, and will certainly exceed, 120 per cent of national income. Until the joint EU/IMF rescue package was announced, financial markets were increasingly chary of new Greek debt offerings. The yield had climbed from four per cent at the start of 2006 to more than seven per cent in early April. So the adverse change in interest rates by itself added as much as four per cent of national income to public expenditure, while the total debt interest charge increased to reach almost nine per cent of national income. In Ireland, where the interaction of banking failure with public debt is undoubtedly a monster, civil service pay has been cut by ten per cent and may need to be reduced again.

What about the UK? New Labour boasted about its prudence in its early years, although in fact it inherited excellent public finances from its Conservative predecessors. Britain’s national debt, which was under control in the 15 years to 2008 at about 40 per cent of national income, will probably peak at above 100 per cent in 2014 or 2015. Assuming an interest rate of four per cent, the permanent additional tax burden will be 2.5 per cent of national income. The long-term damage to incentives from having to pay those extra taxes will fall on us, the taxpayers, for many years. That is the true cost of New Labour’s mistaken flirtation with Keynesian so-called “fiscal reflations” in its closing phase. The evidence of the last 40 years is that extra government spending and budget deficits do not boost aggregate demand.

However, an arithmetical certainty is that they will increase our future tax bills as we are forced to pay more interest on government debt.