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On Debt

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"Annual income twenty pounds, annual expenditure nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty and six, result misery".

Poor old Mr Micawber should know, he ended up in debtor's prison when he was unable to meet his creditors demands.

The world has a tense relationship with lending and borrowing, even the words used, from the latin "credere," to believe, from which we derive credit as an act of faith, and its opposite, "debitum," a thing owed, "a duty," hint at underlying doubt. They add an almost religious overtone to financial exchange. The German word for debt, "schuld," goes even further, conveying notions of "guilt, fault and liability" onto the hapless borrower.

It is ironic then, that the very act of money creation in the modern world begins with the creation of a debt. For example, when your bank credits your account with a mortgage, or a business takes a loan to invest in additional capital stock.

In an ideal world, demand for credit funds the growth in the economy that will later service that debt. What makes debt dangerous is when it is used for simple consumption. When the champagne bottle lies empty, the debt that bought it remains only too full.

Public sector accounts are widely criticised for failing to acknowledge the difference between revenue expenditure and capital expenditure. Gordon Brown's old mantra of "borrowing only to invest," pointed to exactly that. Debt-funded expenditure can be hugely valuable but if, and only if, it is productive.

When people look at debt ratios, they tend to forget to look at the asset side of the balance sheet. Nonetheless, every debt creates an associated asset. It is the quality of the assets that count. Borrowing to splurge on champagne will lead inevitably to perdition; borrowing to maintain employment, businesses and trade today will lead to higher growth tomorrow.

The world does have a problem with debt. It entered the Covid crisis, despite a decade of post financial crisis austerity, with debt ratios higher than at the start. Nevertheless, Janet Yellen, former Chair of the US Federal Reserve and now President Joe Biden's nominee for US Treasury secretary, will argue this week for an additional $1.9 trillion stimulus plan on top of the $3.9 billion of support already provided. At the same time, Joe Biden's team is working on a further "multi-billion" stimulus to invest in "infrastructure, green energy, healthcare and education."

The US deficit, the difference between current revenue and current expenditure, already at $3 trillion will rise substantially further.

In Yellen's words, "Neither the president-elect, nor I, propose this relief package without an appreciation of the country's debt burden. But, right now with interest rates at historic lows, the smartest thing we can do is act big."

In other words: ignore the debts but create the assets that are the foundation of long-term and sustainable growth. How can this be feasible?

Government is different to you and me; though individual governments do, "government" doesn't have a shelf-life.

The British government did not pay off the debts incurred in the South Sea Bubble, the Napoleonic War, the Crimean War and WW1 until 2015. Governments can warehouse debt for centuries and unlike you and me can issue debt (borrow money) in perpetuity i.e. with no maturity date. Indeed, many institutions are calling for such longer issues to help match their long-run liabilities.

As Joe Biden takes office, we are likely to see a modern “New Deal” unfold, funded by debt, that will have effects that ripple across the world. Joe Biden is going to make use of the record low rates that Janet Yellen alluded to *(quite why interest rates are so low when world debts have never been higher is a conundrum for another post)* to raise US investment and to renew US infrastructure.

If it works, revitalised US capital will fund the associated debts and boost US profitability. If it fails, such a massive mobilisation of borrowed capital will lead to inflation as supply bottlenecks collide with too much money in circulation.

Mr Micawber went through life convinced that, “something will turn up.” It is probably fair to say, something has!