

Funding the Future

The problem the world now faces is that governments jus...

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There was [an article in the Wall Street Journal](#) yesterday in which the opening line was enough to grab attention:

The world is running out of safe financial assets.

The Wall Street Journal is heavily paywalled so a synopsis will do: what it is important to realise is that the assets in short supply are, most especially, government bonds. The main reason is that government bonds now play a crucial role in the world's financial markets as collateral when lending.

This is a relatively new phenomena: until 2008 companies were willing to put massive sums on deposit with banks without requiring security to ensure that they would be repaid. Then the banks failed. As a result what became apparent was that banks' capacity to repay was dependent upon the whim of the governments who were really underwriting their solvency. The significant growth of what is called the repo market is the consequence. To simplify somewhat, companies do not now deposit money overnight, leaving them as unsecured creditors of the bank. Instead they sell the bank the most secure and financially stable asset they can use (government bonds) with a contract that guarantees them the right to require the asset the next day with the price adjusted for overnight interest. What that means is that if the banks fail then the companies depositing cash overnight are not unsecured creditors; they do instead have an asset to reclaim. What that means is that their risk is reduced, which is a good thing. It's like the bank deposit guarantee most personal customers enjoy and rely on. At the same time the liquidity of the world's markets is increased, and again that's of benefit.

But there's a problem: there are not enough government bonds to go round. The European Central Bank is actually having to lend bonds it has acquired under the EU quantitative easing programme back into the market to fulfil this role: it is effectively standing as guarantor as a result. And bond borrowing is now so common that I am told that the risk of one bond being used for security multiple times is real: that blows the whole purpose of the transaction apart.

The answer is obvious, of course. We need more government debt.

It so happens that what the markets want is what the economy needs. There is a need for massive increases in government borrowing to fund new infrastructure problems. Only that can really address to social and economic issues we really face. And we can afford it, because people are still desperate to buy such bonds even [with equities at absurdly high levels](#). When the markets crash (it is a when: this time is not different) bonds will be the only asset everyone wants.

Only dogma is preventing a solution to the problem the world now faces, which is that governments just aren't spending enough.