Funding the Future

If government debt cannot be repaid - and in a technica...

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The issues I have raised in my discussion on what I consider to be the misstatement of government debt by the Office for National Statisticsin my discussion on what I consider to be the misstatement of government debt by the Office for National Statistics has given rise to some, fairly predictable, uninformed comment; some decidedly informed comment and some comments that may have inadvertently raised issues that I find interesting.

Regular readers of this blog will know that this is not the first time I have raised this concern. But it may be the right time for me to pursue it in further depth, and I am planning to do that, although in what form is not yet clear. Since, however, this blog exists as a bouncing board for ideas, let me offer another one now. There will be others in due course.

That idea is a think exercise: it is not a proposal. But it is an exercise with a purpose because it gives rise to a question that needs an answer.

The think exercise is this. Presume that the UK government decided to repay all its upstanding gilts. At 31 March 2019 there were £1,240 billion of these, given that they had already purchased more than £500 billion of gilts by value by then. And imagine at the same time that they repaid the balances on National Savings and Investment accounts outstanding at that time. This would amount to around another £167 billion, a sum which has again gone up a bit since then, but which fact does not change the exercise.

The government could do this, of course. It can, as we know, ask the Bank of England to create the money to permit this. And the Bank would do as it was asked, because its veneer of independence is just a charade.

The result would be that the UK government balance sheet as at the date of repayment would be restructured. Now there would be no debt on it. There would instead be a substantial, in fact equal and opposite, increase in the sum on central bank reserves due to banks on that balance sheet. There would, in other words, simply be more cash on deposit, which at that time would then have amounted to around £2 trillion.

And now let’s presume that the government decided that it was going to pay no interest on central bank reserves held by banks. This would not be hard to achieve. It could either change base rate, or simply change the law or regulation on this issue. As it is, right now we’re discussing an issue of just 0.1%pa. So no-one need get worked up about this issue.

And what we would then have is a government balance sheet where literally all the so-called government debt had been replaced by what can only be described as cash deposits.

Now, of course it can be claimed that these cash deposits are liabilities. But that is an almost meaningless claim. First, it takes some imagine to suggest that cash created by choice by a government is a liability. Second, the only means by which this liability can supposedly be ‘repaid’ is by actually using the currency in question, which would then have to be immediately redeposited in the central reserve accounts, which suggests it is not a liability at all. And third, even if one bank did make a call on the reserves (and that will, of course, happen, day by day) the call is matched by a deposit in another bank, exceptional circumstances that will be covered by effective government guarantee apart.

In other words, what the think exercise shows is three things. The first is that government debt need not exist. Its existence is not a matter of necessity, because it can be cleared. Its existence is, then, a matter of choice. That’s not a position most of us are in with regard to our liabilities, of course. But is a so-called liability properly called a liability in that case?

The second is that the liability that supposedly exists could be substituted by cash at any time, which is a right peculiar to the government alone as a the sole currency creator.

And third, that if that substitution with cash took place the supposed liability cannot as such be repaid, because the only mechanism to repay this liability that is denominated in the currency of the country is to use that same currency, which would be an entirely circular transaction.

This, of course, should not be a surprise. It most certainly won’t be to those who understand modern monetary theory. And all I have done is explain within a macroeconomic framework what happens if a person goes into the Bank of England and asks that they be be paid the £20 (or whatever) that the Bank says that they have promised to pay on demand on a note of that denomination, whereupon they will be paid another £20 note.

The point is actually very straightforward. Since government debts - whether NS&I

balances or gilts - are simply mechanisms for depositing money, which money was itself always created in the first instance by the government spending it into existence in the economy and then deciding not to tax it all back, all this debt is already simply a form of money deposit account, even if the gilt variation is in the form that can be traded as debt. And therefore all debt can be substituted by money. And that money cannot be repaid by the government because any attempt to do so does not change the amount of money in circulation.

That is not to say that the amount in circulation cannot be changed. Tax can reduce that sum of money in circulation by destroying the money paid in its settlement, whilst more money creation can increase it. But as it stand as, the so-called debt can’t be repaid from the perspective of the government as a money creator.

But in that case why is it called debt?

And why is it shown as debt on a government balance sheet?

Shouldn’t it be described as something else?

And what is that something else? Might it just be capital? After all, that’s also a credit on the balance sheet, but it is not debt. Why isn’t it treated as such? And why, in that case, isn’t its increase celebrated?