

Twitter Thread by Tony Yates



Tony Yates

@t0nyyates



OK, I'll bite. This is an excellent question, not just a genuine one.

Genuine questions: if most governments are borrowing heavily to pay for the cost of the pandemic, who are they borrowing from, and is there some mechanism in place for them all to agree to right off most of each other's debt? Oh, and if not, why not?

— Armando Iannucci (@Aiannucci) October 17, 2020

There is not a mechanism in place to write off most of each other's debt. There doesn't need to be.

Not all governments are borrowing, for starters. The ones that are are borrowing from their citizens, and foreign citizens, who have stuff to lend.

These are probably mostly the rich, the middle aged, who are saving, and will accept government IOUs, and the old, who have piles of assets and are ok with more of them being in government IOUs, for now.

You can tell that this isn't a problem yet because there is plenty of demand by those who have savings to swap them for government bonds as they get issued, as the bonds trade for a high price [very low interest rate].

Alongside these sales to citizens, there is the small matter too of central banks creating money to buy quite a lot of them.

@Aiannucci rightly wonders what will happen at the end of all this? Will all governments agree just to cancel the debts? Implicitly saying 'because of course no way can we pay them back'.

Obvs I can't tell what will happen in the future. It may be that some govts decide, or are forced to say 'sorry, not paying that IOU' and default. I hope that this doesn't happen, and it doesn't need to happen.

Provided the costs of servicing the debt stay low, the debt can be 'rolled over' pretty much indefinitely, allowing some combination of the following to get it to 'go away'.....

By 'rolling over' I mean: when one IOU comes due, you make good on it by first finding a new person who has savings who is happy to have a new IOU from you.

And slowly, over time, then, the debt burden is shrunk by 1) a bit of gentle tax raising, 2) allowing economic growth to shrink debt relative to national income, 3) probably a bit of inflation too.

This is how 'paying down' WW2 debt worked for the UK. Probably we had too much inflation; and the tax was levied covertly by repressing the savings/investment industry in the UK ['financial repression'].

Behind the original question is the implicit worry that this can't go on forever, can it? No, it can't, there are limits to how many of these IOUs you can hope to sell to citizens at home and abroad.

But these limits seem to be a long way off at the moment. It's important not to abuse the privilege that is afforded us by being able to sell these IOUs to fund the national crisis effort now. Because our kids and our kids' kids might need to do the same themselves.

Not abusing that privilege means doing pretty much what the buyers of the IOUs could have hoped and expected when they parted with their savings. Following through and making good on them as and when.

To be sure you can do this you can't let the amount of debt outstanding get too far out of line with the income you can lay your hands on as a govt. What 'too far' is very difficult to know. And we have learned that 'too far' is further than we thought say 20 years ago.

Hawkish govts and commentators have done lots of damage by abusing this perfectly sound logic that there are limits, confecting arguments that finances are about to hit the skids. [Those invoking the Reinhart/Rogoff spreadsheet with the error in, for example].

These things are invoked - in good or bad faith idk, probably incidences of both - to force us to think we have to have small, ungenerous states with mean policies that don't properly compensate people through recessions and hardship.

Invoking the limits argument in bad faith, or just badly, has also stoked the equally bad idea [emanating particularly from MMT] that there are no limits, or no practical limits, that taxes don't fund govt spending, and that you can use the printing presses and not worry about it

Which brings me to the money bit. You didn't, but you might well have reasonably interjected, when I mentioned that central banks were buying a lot of debt: 'aha, what's going on there, isn't *that* just more made up debt and isn't this just going to have to be cancelled?'

Again, who knows, but there is no need for a bad outcome here. The money created, so long as it continues to go hand in hand with relative stable prices, reflects the same demand [mostly by own citizens in this case] to put some of your worth into just another govt IOU.

This IOU has a picture of the queen on it and gets exchanged in shops. Not the same as a govt bond, but is not so different either. At some point, we do have to worry about making sure that the money printing gets 'undone', as and when not undoing it threatens high inflation.

Remember before that I said that some of the shrinking of the real value of the actual govt IOUs would happen with inflation. That will be engineered, if all goes well, with delicate printing of the picture of the Queen on them IOUs.

This thread generates the illusion of great knowledge and confidence, and consensus about what should happen and tramples on many details that are argued about, but I hope it captures the basic idea that things can be ok.

If anyone knows Armando, tell him I tried to answer. His mentions are probably too ridiculously long to ever bother looking to find out.

Right, waiting for all the monetary and fiscal theorists to start machine gunning this thread.

Since this is bouncing around... it's worth going back here and asking ourselves: ok, so this won't end in tears, if things go well, but is it nevertheless worth doing?

The answer is YES! Colossal fiscal support, much more generous than we are offering currently, is needed to support compliance with social distancing, and to compensate those affected as much as possible.

In this way, the government uses the benefits of its predecessors not having abused the perpetual ability to raise finance, to raise it and act like a social insurer.

We weren't individually prepared, and could not have insured ourselves against covid if we tried. The govt support and financing is a call on an insurance policy maintained by all past and future generations, one that we contribute to a bit ourselves in analogies to premiums.

In figuring out the 'insurance payouts', we have to be careful to note the terribly regressive nature of the shock. Poor people find it harder to socially distance in small accommodation, more densely populated areas, and are less likely to be doing nice work from home.

And the insurer [that's us really] has to be mindful of the overall scheme. Remember future generations are going to have their own disasters, some of which are foisted on them by our neglect of our collective failure to address carbon emissions.

By 'be mindful' I mean, return the favour of not abusing the accumulated reputation for not abusing the privilege of being able to raise money cheaply, and respect therefore the fiscal limits, a long way off and uncertain though they may be.

At the same time as cautioning against abuse, we have to balance this by remembering that the accumulated reputation for not abusing the financing privilege is not an end in itself, just like price stability [what you get by not abusing money printing privilege] is not an end.

THE WHOLE POINT of previous generations investing the effort of discipline is that we can do the financing, and protect the fabric of the state when we need to do really big things to achieve it.