Binge Borrowing

The banks get into trouble because they have made unwise loans to clients unable to repay, and they drag the Western economies into recession. Western governments apply Keynesian economics and double their national debts in order to get out of the recession quicker. In the UK a "deal" (as agreements and bargains are now always called) is done between the government and the banks whereby the banks agree to increase their lending substantially.

If the banks are forced to lend, whatever their judgement of the quality of the loans, the result must be a return to square one at an accelerated pace.

Her Majesty's Government has set them a splendid example. They seem to be under the impression that loans to the Republic of Ireland will be repaid! Speculators of the George Soros class look set to make a lot of money by backing a more commonsensical opinion. The Government itself does not, however, lend from its capital reserves. It gets the money to lend partly from taxation and partly from borrowing, because in the great world of finance, hard-headed investors put in the British Government the same faith that the British put in the Irish. The Irish can then be made to pay a higher rate of interest than the HMG, which profits—until the Irish default.

The underlying questions are whether loans are a good method of finance, and whether the present generation of loans is compatible with honest money. Analogies made between individuals, families and states are not always illuminating. In the case of money, what is true of the individual or the family is usually also true of national economies and the global economy.

On the whole, it seems sounder, financially and morally, to save up for something than to buy it on credit. To save for something helps the saver to realise its value and that it does represent the fruit of work harder to do than clicking the *buy now* button and filling in credit-card details. To buy goods and services out of income or savings disciplines the purchaser not to buy rashly what cannot be afforded.

Be that as it may, in the modern world we (individuals, families, nations) purchase goods and services on credit. Where the loan is secured against a reliable asset the borrower can always in principle get out of debt by surrendering the asset. The large-scale example is the "home loan". If in the UK many people now own the houses they live in that is because it was possible to pay for them over many years while living in them. There was also good reason to expect unearned capital gain. But unsecured debts incurred just to maintain or enhance a "lifestyle" . . . are they ever a good thing, whether incurred by individuals or families? Or by nations?

Honest long-term debt is not an economic stimulant. Whatever goes on interest payments and repayment of debt cannot be spent on anything else. This must be a brake not an accelerator, except over a very short term. The binge on borrowed capital may be one crowded hour of glorious life, but the hangover then goes on and on. You think it is an exaggeration to compare the national debt with binge-drinkers who run into debt to finance the binge, and with no idea how to pay?

What is beyond reasonable question is that loans incurred with the intention of never paying them off are morally and financially dodgy. Such are the monstrously huge sovereign debts all over the Western world.

Labour, after a number of years promising a balanced budged over the trade cycle, i.e. not to increase the national debt, ended up by increasing the national debt at a rate unknown before except during world wars. They now, as a powerful opposition, daily call the coalition's plans for spending cuts "reckless". Their victor in the Barnsley by-election of 3 March 2011 (elected to replace his Labour predecessor at present in gaol for expenses fraud) used the word in his speech of triumph. Mr Brown also used to make much use of the adjective *prudent* about his own policies. Labour seems to have managed to impose these new meanings.

Mr Osborne's reckless prudence does not, however, consist in beginning to pay off the national debt, but in slowing down its rate of increase. He plans an INCREASE in the national debt over the next five years, that is, into the predicted first year of the next Parliament, of *four hundred thousand million pounds*. (Try saying that sum of money three times slowly.)

It is not intended to pay off these debts. As gilt-edged stocks (= IOUs issued by the state) mature, they are replaced by new ones, that is, new debt is incurred to pay old. The debt remains. But it is not such a drag as it was. War Loan 3½% (undated, originally 5%, 1½% of which was later confiscated) would only be repaid at par if it could be replaced with a cheaper debt. But in any case it is now worth only a very small fraction of what it was worth when people bought the original issue, and the dividend has similarly all but vanished: by means of inflation.

Inflation was the great method in the second half of the twentieth century for not paying off debts, and without, it is hoped, the lender noticing. Inflation is inherently dishonest. Someone lends in the good faith of getting the same money back, and does indeed, if all goes well, get the same sum: but not the same value. The longer we have to wait for a return to honest money, the lower in real terms will be the national debt (and all other sterling-denominated debts) and the better all the deadbeat parties will be pleased.

For a few years it looked as though this would change, after Mr Brown gave control of interest rates to a committee chaired by the governor of the Bank of England, with the remit to maintain annual inflation within 1% either side of 2%. This worked for just as long as it was unnecessary. British inflation is now more than double the target rate and forecast to go higher. The national debt is thereby being reduced in real terms in the time-honoured way, even if the reduction is not as great as the planned increase, and not as spectacular as during the 1970s.

Why has not the interest-rate-setting committee resigned or been dismissed? Answer: either because they are not genuinely independent and are doing what the chancellors tell them, or because they understand that their real task, to stoke the “recovery”, has priority over their public terms of reference. It must seem that the second is more probable, otherwise when the Governor of the Bank writes his monthly letter of apology to the Chancellor he would be more forthright. For about a year he has been expecting inflation to peak in the near future then fall back. The climb towards a peak goes on as predicted but the falling back is still awaited, at about the same distance in the future.

From this we learn that central bankers, appointed in numerous democracies because elected representatives cannot be trusted to contain the inflation which elected politicians are prone to use as an election-winning device, can be as susceptible to the charms of printing money as any of the chancellors. Mr Bernanke sets the example for Mr King.

Whether artificially cheap money is a good way of encouraging economic activity is another question. So far the “quantitative easing” (the popular name for which, “printing money”, is only inaccurate because with cybertechnology it is not done on paper) has been having a more predictable effect. Interest rates have to be kept low so that the state needn’t pay much to borrow, and cheap money finds its way into assets. What else should you do with your money when the banks are paying about 4% less then the inflation rate—that is, when the interest they pay does not cover the loss in real value? So the house-price bubble, which for decades has been depriving the young of homes, has been, albeit limply, reinflated. Since the crash the stock market has had two very good years. This cannot get anybody back to work apart from the “proprietary traders” (= speculators/gamblers) in banks.

The great experiment in Keynesian economics, as understood in Washington and London, continues. In the long term, when as Keynes said, we are all dead, it would probably be healthy if the money-printing failed, and the real national bankruptcies were admitted. If the Chinese dollar holdings became valueless it might show the Chinese the oddity of keeping the Americans in the style of life to which they are accustomed by lending them money to spend on Chinese goods. There is no good political or economic reason for this Chinese altruism, except that to change would cause an upheaval.

Would it not be better if we all started making things and paying for them?