

State debt and money printing

Time was when I and many other economic commentators would have rightly warned that a country cannot take on too much debt as it has to pay the interest and pay it back one day. It needs to live within its means. I would also have confirmed that any attempt to simply print more money to spend in the public sector or to use to buy up the debt would lead to high inflation, and would come to create a deep recession as hyper inflation undermines normal activity.

There are plenty of examples from history and current economies to show what goes wrong if a government tries to borrow and print its way out of economic troubles. Call it the Weimar model, from 1920s Germany, or the Zimbabwe model from that country in the first decade of this century. Or call it the Venezuela model, still living through the disastrous consequences of borrowing and spending too much in the public sector and trying to print its way out of the debts. A government that prided itself on generous handouts to the poor ended up leaving the poor hungry and roaming supermarkets with little food. Hyperinflation set in. That clears the shelves of goods, drives imports sky high in price as the currency plunges, and undermines investment and business. Venezuela, the country with the world's largest oil reserves has been unable to pump much oil, as the oil wells go without maintenance and the transport fails.

But today I need to report that the Euro area, the USA and the UK have embarked this year on a major programme of expanding state debt, and their Central banks have printed a large amount of new money, politely called Quantitative easing. Indeed, to save the world economy the Fed created an extra \$3trillion this spring. We should be grateful, as it was needed.

I will call this the Japanese model. For 30 years now since her huge credit crunch and asset price crash, Japan has followed a policy of greatly expanding its public debt, and buying in large quantities of it with money created by its Central Bank. State debt in Japan is now around a remarkable 250% of GDP. It stands at 1,328,000,000,000,000 yen. Despite this Japan suffers from practically no inflation, output is fairly stable, investment continues and the currency is behaving well against others.

So far the actions taken by the USA, UK and the Euro area during the pandemic have shown that we can at least temporarily follow the Japanese model. We should not, however, assume we will be able to do this indefinitely or will need to do what Japan has done for some 30 years. We cannot assume our economies will remain immune to inflation, that our currencies will remain relatively stable against others, were we to persevere with too much debt and too much money printing.

It has been possible to do it so far because the anti CV19 measures were such a big hit to demand and incomes, that it needed an equally large offset from borrowing more and creating more money. There was no shortage of goods for the money to buy, apart from a few specials like PPE which duly shot up in

price. The UK has decided it can afford to expand state debt above 100% of GDP, and has set out on a course of creating an additional £450 billion of new money, on top of the £445bn of QE money inherited from previous governments and the banking crisis. This should be fine, and gives the UK a crucial breathing space to make the unusual and large expenditures caused by the CV 19 response. In effect this newly created money will pay for the excessive one off costs of the pandemic policies. It would be best to assume that as we recover we need to bring the special measures to a well timed end. Too fast and we are back to recession. Too slow and we are on to inflation.

The UK state through the Bank of England will own well over 40% of the large state debt it is building up. The Treasury pays interest to the Bank and the Bank sends it back as a dividend to its government owner. This is why I am less concerned than many about the level of debt. This view is reinforced by the way so far the UK can borrow large sums at near zero interest, removing the normal pressures and constraints on borrowing more.

Confidence remains a precious flower. The government must seek value in all this extra spending, and have plans to get back to something more normal in good time. The Japan model works for Japan, but Japan usually has a balance of payments surplus, an ageing population with a savings habit and years of experience of no price rises. The US and UK with large trade deficits and a history of more inflation are only temporarily able to follow the Japanese model.