Should we be scared of the coronavirus debt mountain?

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27 avril 2020

We do not know how this pandemic will end. We do know that we will be poorer when it's over: GDP is plunging around the world.

We also know that there will be a towering pile of IOUs left from the bills run up during the crisis. When it is over we will have to figure out how to repay them – or whether to repay them at all. That question will decide the complexion of our politics, and the quality of our public infrastructure and services for years to come. Unless we tackle this issue, coronavirus debts will be the battering ram for a new campaign of austerity.

The scale of the challenge is huge. Hard cases like Italy grab the headlines. Its debt currently stands at 135% of GDP. As a result of the crisis it will likely rise to 155%. But it is no longer an extreme outlier. According to the IMF, the debt ratio of the average advanced economy will exceed 120% next year. In the US, the debt to GDP ratio may soon surpass that at the end of the second world war.

These numbers are impressive, daunting even. They offer an open door to conservative scaremongering. The first move in that tradition of debt politics is to invoke the tenuous analogy to a household. In this picture, debts are a burden on the profligate; a moral obligation that must be honoured on pain of national bankruptcy and ruin.

There are some circumstances in which this analogy is apt, specifically when you are an impoverished and desperate country dependent on foreign creditors who will lend to you only in the currency of another country, most commonly that of the US. Many poorer countries are in this position. Few rich countries are. Indeed, one of the definitions of being an advanced economy is that you are not.

Advanced economies borrow in their own currency and overwhelmingly from their own citizens. For them, the household analogy is profoundly misleading. In fact, those seeking to rebut the misconceptions of the household analogy sometimes say we merely owe government debts to ourselves.

That is a liberating thought. It makes clear that we are not in the position of a subordinate debtor nation. But it has a dizzying circularity to it. If we are our own creditors, are we not also our own debtors – master and slave at the same time? Ultimately, it is a *bon mot* that relies on treating the economic nation as a unit. That may look like liberation, but it is an illusion achieved by removing the real politics of debt – which are about class, not nationality.

Historically, government debts were assets owned by the middle and upper classes, the famous rentiers. And taxes were overwhelmingly indirect and thus fell disproportionately on lower incomes.

Today, the richest still own a disproportionate share of government debt. But the liabilities of the government are now widely distributed. They are staple investments for pension funds and insurers. Government debt is not simply a burden; it is a highly useful financial asset, offering modest interest rates in exchange for safety. It is all the more useful for the fact that the government lives for ever and will generate revenue for ever through taxation. So it enables very long-term planning.

The tax base today is much broader than it was a century ago. But who pays taxes – and who does not – remains one of the most urgent questions of the moment. A world in which coronavirus debts are repaid by a wealth tax or a global crackdown on corporate tax havens would look very different from one in which benefits are slashed and VAT is raised. And it is very possible that debt service will be taken out of other spending, whether that be schools, pensions or national defence.

As the great Austrian economist Joseph Schumpeter remarked in the aftermath of the first world war, “the budget is the skeleton of the state stripped of all misleading ideologies”, the truest reflection of the distribution of power and influence.

It is a distributional issue. But not only that. Debts may also affect the size of the cake itself. As we know only too well, a regime of austerity that keeps taxes high and government spending low is not conducive to rapid economic growth. And yet for debt to be sustainable, what we need is growth in GDP – to be precise, growth in nominal GDP, which includes real economic growth and inflation. Inflation matters because it acts as a tax on debts that are owed in money that is progressively losing its value. Price stability, the objective of monetary policy since the 1970s, no doubt has benefits for everyone, but most of all the creditor class.

This is the awesome dilemma we will face in the aftermath of Covid-19. This is the battle for which we must brace. Not right now, but once the immediate crisis has passed. After the financial crisis of 2007-08, it was in 2010 that the push for belt-tightening began. Like revenge, austerity is a dish best served cold.

Progressive politics cannot, of course, shrink from a battle about budgetary priorities. But it should resist fighting on the terms set by austerian debt-fear. In the circumstances of the UK or the US, alarmism about debt is false. And how false is being demonstrated by the crisis itself.

There is one mechanism through which we can ensure we truly owe the debts to ourselves. That mechanism is the central bank. Its principal job is to manage public debt – and at a moment of crisis central banks do what they must. They buy government debts or, in what amounts to the same thing, they open overdraft accounts for the government.

That has two effects that, acting together, have the potential to negate debt as a political issue. Central bank intervention lowers the interest rate. If interest rates are held down, debt service need not be an onerous burden. At the same time, the central bank purchases remove government IOUs from private portfolios and put them on the balance sheet of the central bank. There, they are literally claims by the public upon itself.

When the central bank buys the debt it does so by creating money. Under ordinary circumstances one might worry about that causing inflation. But given the recession we face that is a risk worth running. Indeed modest inflation would help us by taking a bite out of the real value of the debt.

Of course, ensuring that the central banks continue their crisis-fighting methods into the recovery period will itself require a political battle. Fearmongering about inflation is the close cousin of fearmongering about debt. We should resist both blackmails. We have the institutions and techniques to neutralise the coronavirus debt problem. We owe it to ourselves to use them.

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