



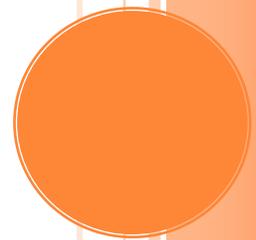
**MACROECONOMIC**  
Analysis & Policy Studies

## **All 'Debt' Matters**

Student Research Internship Report

Mahima Yadav

July 2021



## All 'Debt' Matters

An Essay of the Relative Importance Accorded to Public and Private Debt in Policy Debates

Mahima Yadav<sup>1</sup>

### **The Ticking Bomb That Never Goes Off**

West of Sixth Avenue in Manhattan, New York City, the US's national debt clock is ticking by. As of July 2021, the US government is sitting atop a staggering \$20 billion worth of public debt and every passing minute, that number is growing. A warning from the Congressional Budget Office is in order - the Treasury stands to run out of cash by as soon as October. The Senate is now staring at two options - to either raise the debt ceiling or suspend it altogether, lest the US imperil its sovereign rating yet another time - like 2011 all over again. If there's anything that looms larger than the fiscal deficits governments are running today, it is the stigma around fiscal deficits.

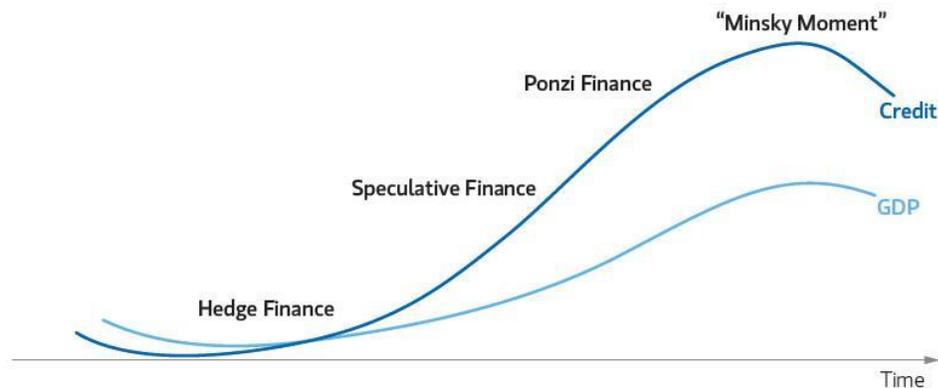
### **Of Manias and Panics**

Before digging into the whole fear-mongering around fiscal deficits, let's go back to the run-up to the financial crisis of 2007. What came to be known later as 'The Great Moderation' was the longest running economic expansion seen since World War II, spanning from the 1980s to 2007 - a defining period for the course of monetary policy. Emboldened by a period of price stability, reduced business volatility and sound economic growth, banks decided to expand their credit big time. The system blew up after Lehman Brothers declared bankruptcy in September 2008 - and a financial crisis erupted through the American banking system, dragging the real economy down and rippling across countries worldwide. In a moment of epiphany, the world realised how exotic financial instruments (like credit default swaps), reckless lending practices (NINJA loans, for instance) and ultra-loose monetary policy had come together to wreak havoc on the financial system. This was the worst economic catastrophe seen in over 70 years and it was private sector risk-taking, not fiscal profligacy that had led to its genesis. It was the classic Minsky cycle at play - a period of benign growth spurring excessive risk-taking, overleveraging and speculation until the risks started translating into actual losses, resulting in deleveraging and massive sell-offs.

---

<sup>1</sup> I, Mahima Yadav, hereby declare that the contents of this article are not plagiarized and reflect my own views. This article was written as part of a research internship at FAIR India, under the guidance of Dr. Sashi Sivramkrishna.

Stylized "Minsky Cycle"



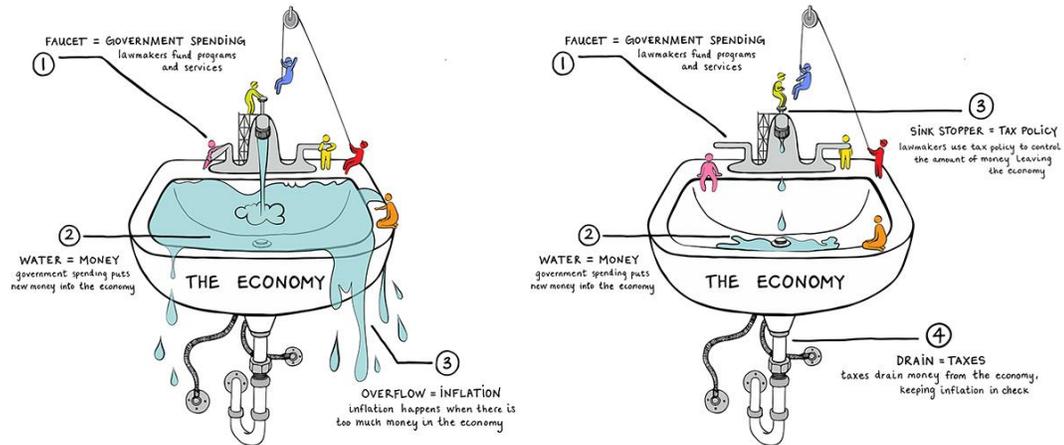
### Debt It Be

Increased financialisation and deepening of financial institutions has certainly brought with it countless benefits. The development of the financial sector well feeds into the real sector of the economy. But while being apprehensive about fiscal deficits and public debt, are we looking past what looks like a bigger cause of concern? History lends little support to the idea that the worst financial crises are born out of public debt - the claim is feeble, at best, when we consider countries with monetary sovereignty. Yet, it's perplexing how an advanced economy like the US has its Senate anxious about "getting the fiscal house in order". No matter how hard the US tries, it can never pull off a Zimbabwe-like hyperinflation episode or a Greece-style debt crisis. Neither can Japan or Australia or India, for that matter because these countries print their own currency - they have monetary 'sovereignty' (unlike the Eurozone economies that relinquished their monetary sovereignty the day the Maastricht Treaty was signed). These nations borrow in their own currency by issuing government bonds (unlike Argentina, which took out a loan denominated in US dollars, from the IMF) and operate on a free floating exchange rate regime (unlike Latin American economies that pegged their exchange rate to the dollar). This is not to say that governments can expand their perceived 'fiscal space' indefinitely without bothering about the consequences. There is a limit to how much room there is, and that limit is defined by inflation.

### Our Classical Thought Framework

The obsession with themes like 'public debt' has, in part, to do with the fact that these issues are more politically charged. Governments can't be held accountable for speculative activity in credit markets but when S&P slashes the sovereign credit rating, it naturally implies the government was 'unrestrained' in its spending. The increase in government spending is believed to 'crowd out' private investment and lead to a spike in interest rates - a clear manifestation of how we still choose to work with remnants of outworn ideas such as the loanable funds market.

## MODERN MONETARY THEORY



### It's Just a Fringe Economic Theory

While there is a natural tendency among academics to appreciate scholarships of different people before deciding what's the 'right' answer, this is the fork between science and economics. We are too reluctant to give novel theories space in modern day debates, too reluctant to part with our set ways of thinking - unlike science, which let Planck and Einstein change the face of physics forever. It's rather appalling that the economics community choose to present a dumbed-down caricature of the Modern Monetary Theory, which, more than anything, is a lens to look at the economy from a new perspective. Contrary to what mainstream media has to say, MMT does not prescribe that the government can spend as much as it wants and most importantly, does not disregard inflationary concerns. Inflation is at the core of MMT's ideas - in fact, inflation is the only real constraint that matters. For a monetary sovereign country, the fiscal deficit is not the deficit that matters - the deficit in achieving potential real output is. Stephanie Kelton, one of the most vocal proponents of the theory, often quotes, "The question isn't 'How will you pay for it?', the right question is 'How will you resource it?'"

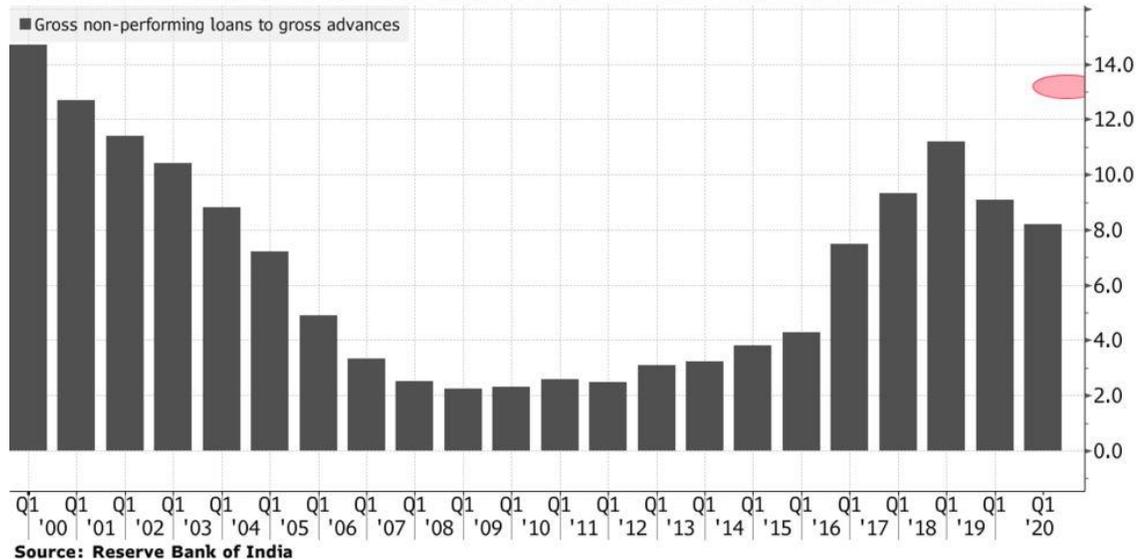
### The Numbers That Should Bother Us

Most governments worldwide are more indebted at this point, than they have been at any other point in history. As of February 2021, government debt stands at 105% of global GDP while non-financial private sector debt stands at 165%. On account of loan moratoria and hot housing markets, household debt expanded to 65% of GDP in 2020. Here's what a research from SBI, India's largest public sector bank, had to say in August 2020 - even as consumer loans declined by Rs. 53,023 crores in the current fiscal, "consumer leverage in lieu of

exposure to stock market” rose by Rs. 469 crores. That is the ‘right’ talking point. That is the ‘debt’ we should be worried about, before we hit the Minsky moment again.

## Pandemic Stress

Indian banks' soured debt ratio is set to rise to 13.5% by September 2021



### ...And Some More

In a 2019 report, McKinsey & Co. labelled India’s corporate debt situation as “ominous”, citing that 43% of long-term loans face the risk of potential default. A report by Credit Suisse in the same year flagged 49 corporates as ‘chronically stressed’. With nearly 10% of gross loans classified as NPA, India fares worse than most of its emerging market economy counterparts. The top 10 wilful defaulters owe the nation’s lenders a whopping Rs. 84,632 crores. It is not just the quantum of private debt that is the problem, it is also the deteriorating quality of credit.

### Economics’ Copernican Moment

As Planck’s principle puts it, “Science progresses one funeral at a time.” Maybe, it’s time for Economics to follow suit, it’s time to turn our attention to the deficits that matter. As long as the government has monetary sovereignty, it can always print more money to fund projects that help achieve concrete and specific economic goals - the private sector can’t. The government is a currency issuer whereas the private sector is a currency user - that makes a world of difference. It is private debt that needs its fair share of attention, not just in India but globally, because as MMT puts it, ‘A sovereign government borrowing in its own currency can never go broke!’ But the private sector, in theory and practice, just might.

### References -

1. <https://voxeu.org/article/private-and-public-debt-crises-1870-now>
2. <https://democracyjournal.org/magazine/42/the-private-debt-crisis/>

3. [https://www.iif.com/Portals/0/Files/content/Global%20Debt%20Monitor\\_Feb2021\\_vf.pdf](https://www.iif.com/Portals/0/Files/content/Global%20Debt%20Monitor_Feb2021_vf.pdf)
4. <https://www.businesstoday.in/opinion/columns/story/indian-economy-npas-why-indian-corporates-are-debt-driven-non-performing-assets-269182-2020-08-05>
5. [https://www.business-standard.com/article/economy-policy/india-s-debt-to-gdp-rose-to-90-during-covid-19-pandemic-says%E2%80%88imf-121040800168\\_1.html](https://www.business-standard.com/article/economy-policy/india-s-debt-to-gdp-rose-to-90-during-covid-19-pandemic-says%E2%80%88imf-121040800168_1.html)
6. <https://www.livemint.com/news/india/how-india-s-soaring-fiscal-deficit-affects-you-11591183077303.html>
7. <https://www.bloomberg.com/graphics/2021-coronavirus-global-debt/>
8. <https://voxeu.org/article/eurozone-crisis-fiscal-fragility-external-imbalances-or-both>
9. <https://www.imf.org/external/np/exr/ib/2000/062600.htm>
10. <https://www.investopedia.com/articles/economics/08/currency-crises.asp>

#### **Image Sources -**

1. Bloomberg Economics
2. economicsociology.org
3. Marketplace.org