The Origins of Debt and Austerity: Why the Government should borrow more

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“Blessed are the young for they shall inherit the National debt,” says Herbert Hoover, the 31st president of the United States of America. On the issues of debt, Hoover will just be one of the billions of people in the world including famous Economists and financial experts who do not hold any believe different from that expressed by him (Hoover).

Consequently, governments and central bank governors all over the world try as much to create enough fiscal space for their economies by borrowing less and spending 'reasonable' amounts of income so as to stay afloat. In fact, international financial institutions like the Bretton Woods institutions are the front liners when it comes to issues of government spending where they discourage particularly developing countries from spending more whilst encouraging them to tax more and borrow less.

The issue of debt sustainability is so important because it has led to the crumbling of so many economies especially when it is not managed well. Ghana has had to resort to the IMF 16 times since independence for bailout due to debt distress, but this has not yielded significant results to propel the country to development. Debt has crushed so many economies like Greece, Puerto Rico, Argentina etc. It has become a weapon in the hands of government critics and oppositions throughout the world, and in fact, it equally but ignorantly serves as a marking scheme based on which the performance of a country or a certain government is assessed. This has made governments alert on the issues of debt. It is no wonder the government of Ghana in 2019 accented to a bill that sought to cap government yearly deficit at 5%.

However, the obsessiveness of countries to 'look good' outwardly has made them pay less attention to the opportunities that they could harness through debt to catapult themselves to the league of developed nations in the world. On the issues of debt sustainability, the nominal figure of the debt is irrelevant and as a result, Economists prefer to use the debt to GDP as well as annual deficits. Though this is an important tool in debt sustainability analysis (DSA), it has been used wrongly in the sense that, people immediately forget that, it is not about how much you owe, but about how able you are to pay back the loan at the stipulated time. And whether you will be able to pay back the loan, also depends on how you used the money. This is simple! Borrow as much as you can, so long as you have opportunities that will enable you pay back the loan as required without default or having to restructure the debt. Hence, investors are mostly and mainly interested on how your future looks— bright or bleak?

As mentioned earlier, many of those countries that borrow a lot tend to be distressed by these debts thereby crushing their economies. Ironically, though Ghana has a lower debt to GDP ratio as compared to so many of the developed countries (over 105% in US, Singapore 112%, Japan 253% etc), international monetary organizations like the IMF and the World Bank complain often about the level of debt in Ghana which is 62%, than they do about the nature of debt in the developed world, mainly because, they consider the abilities of the countries to pay without having to resort to debt restructuring or default. Most of these developed countries especially Europe and the US have had these high debt levels for a very long time. After the World War II (WWII), Europe was devastated and needed help, and the only country then that could help re-build Europe was the United States. So this led to the formation of the Bretton Woods institutions namely, the IMF, World Bank and the International Trade Organization. These same institutions today exist, and fortunately for Europe, this really did help restore her but not Africa which has been fed with several of billions of dollars ever since. The difference in the success stories is nothing but institutions. Europe had the institutions to ensure that, the money they received was used for the most critical projects that will put them to their feet even though those institutions were in havoc and only needed revamp. Developing countries are not suffering because they are Economically ignorant (read “Why Nations Fail” by Acemoglu and Robinson) or due to over reliance on loans, but because, the loans that they take, usually with high interests do not go to the right institutions. If loans and aid were that deadly, then a devastated Europe should have remained devastated ever after the WWII. This understanding of the DSA then leads us to analyze whether Africa has those opportunities or not which merits more investments.

In our part of the world (developing countries), usually, not much is done by the private sector. The private sector is weak and thus unable to produce and provide enough jobs in the economy. This means, the amount of productivity in a particular economy sometimes depends mainly on government spending. This is so because, private spending in a country like Ghana, depends usually on government spending. Hence, for us to provide more employment opportunities to the numerous unemployed graduates associations across the country, we need to be able to invest massively in certain critical parts of the economy such as agriculture.

It is common knowledge that, the private sector is normally the engine and driver of growth in almost every economy with the potential to develop. But our continent unfortunately is plagued with low savings and therefore low internal investment. Contrary to the widely held notion that, a government that borrows to spend discourages not only public savings but also private savings, Warren Mosler, an American Post Keynesian Economist who is one of the leading pioneers of the Modern Monetary Theory, in his book " The Seven Deadly Innocent Frauds Of Economic Policy" asserts that when government spends, that part of the money which does not return to the government in the form of tax stays in the hands of private individuals which is either spent or kept as savings by cutting their spending. This will then lead to more savings than would have been the case if the government had not run a deficit. Thus, if government deficit is not large enough to cater for these savings desires, then people in their attempt to save will create unemployment since a cedi spent on a good keeps another person in employment. This attempts to explain how government running a deficit is so important, most especially in developing countries like Ghana. What will be the essence of not borrowing more when you know that, borrowing more will only open up dormant sectors of the economy and scale up productivity? Running a zero-deficit economy without much productivity would not lead to development, than would borrowing to spend recklessly without vision lead to debt sustainability.

African countries still have so many important and highly profitable investment opportunities that have not been exploited. Therefore, it is not surprising that, a majority of our people are still unemployed, and large proportion of our citizens still battling the age-long curse of poverty that continue to lurk in every corner of this land of opportunities. This means any government that is able to invest WIDELY and WISELY in the APPROPRIATE opportunities should be able to pay her debt not less than a good business will be able to pay its debt. For instance, the government of President Akuffo Addo has initiated not just an ambitious but also a very laudable policy of 1 village 1 dam in all regions of the Northern part of Ghana which is usually dry for most part of the year (Issue of its implementation will be for another day). This policy if well implemented, will not just provide jobs for the youth, but will be able to immediately provide government revenue through tax from the agricultural produce, help the government reduce the numerous “freebies” that she doles out to the poor in the name of social interventions because living conditions would have improved. Which means, a lot more money can actually be saved by merely borrowing to provide jobs to the people. A clear example now, is the government's planting for food and jobs. It would be unbelievable to have any well-meaning Ghanaian push against the use of borrowed money for such a worthy course.

A famous concern among critics of sufficient government expenditure is that, it will lead to an increase in the inflation and interest rates, which is truly common among countries with high debt levels. The reason is simple to grasp. It is simply because, spending goes with productivity, and so if the loan is spent unproductively like was done in Ghana in 2012 where government had to suddenly spend in excess of 12% of GDP so they could retain power that year, then certainly, such unguided and unyielding spending, will only derail the economy and bring it to its knees. No wonder, rising inflation became prevalent, and GDP growth rate dragged its feet below 5%. This suffocated the fiscal space and even though the government had just ended an IMF program in 2012, it had to run to the IMF in 2015 for yet another credit facility. Thus, a rising inflation can be averted by correspondingly increasing productivity (remember demand pull inflation is simply too much money chasing too few goods. But when too much money is chasing too much goods, then surely, the inflation rate will be stable) and this increase in productivity will lead to an increase in savings as explained above. And as is common knowledge, this rising savings will slow down the interest rate. Externally, the increase in investor confidence due to the prudent and productive use of borrowed money will still keep the interest on our external bonds at reasonable levels. Remember that, the interest on loans becomes “deadly” only when such interest rates exceed the GDP growth rate.

The reason most developing countries are usually unable to pay back their loans despite the opportunities that are as glaring as the numerous cases of malaria, extreme poverty, illiteracy and pockets of tribal conflicts etc. is the huge level of corruption and embezzlements which are pervasive with borrowed funds. Investing borrowed funds into unyielding ventures such as (the building of a presidential palace, buying of chocolate for school children as is currently been done by COCOBOD, use of borrowed funds meant for medical research for research into the electoral chances of a political party etc.) which will never yield anything to pay back the loan. Also, the use of short term loans to invest in long term projects which will not yield returns quickly to pay the debt. These and many others will only suffocate the economy and not create enough fiscal space for the economy to thrive. The 2001 Nobel Prize winner in Economics, Joseph Stiglitz puts it better when he said, “debt in itself is not bad, it is just the channels through which they are expended and how fast they pile up.” Sadly, these are the realities of Africa.

Consequently, the issues with developing countries are institutional and leadership but not debt. And thus, the needless arguments by politicians and policy makers in Africa (particularly Ghana) about which administration has borrowed more is misplaced. The debate should be about how much confidence (which is easily determined by the Economic indicators) has been earned both locally and externally which will affect future bonds and investments and what impact on the economy has been made by government through their prudent and wise use of the borrowed money? For debt, as suggested by the famous economist James Galbraith, “is not a burden in the future” contrary to Herbert Hoover's remark. “Everything produced in the future will be consumed in the future. How much will be produced depends on how productive the economy is at that time. This has nothing to do with public debt today; a higher public debt today does not reduce future production—and if it motivates wise use of resources today”—which unfortunately eludes Africa— “may increase productivity of the economy in the future.” Abba Lerner (renowned for the Lerner's Index), the champion of “functional finance” posits that, “public policy should be judged by its results in the real world-employment, productivity and price stability-and not by whatever may be happening to budget and debt numbers.”