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## STRUCTURED CREDIT

Credit is one of the fundamental features of any high-functioning society. The ability to borrow and lend at a healthy equilibrium is what separates the highest functioning economies from the lowest ones. Credit is built on trust and trustworthiness, which is characterized by its own term, creditworthiness. Credit is such a pillar of our civilization that we created a term to describe a person or organization who is otherwise untrustworthy but can be relied upon to honor their debts. The distinction is primarily between willingness and ability. We assume that everybody wants to honor their debts; however, we find that when push comes to shove, people have varying levels of willingness. For example, when a person owes money to ten different lenders, each debt has a varying willingness that is likely related to the severity of the consequence that would result from a failure to pay. In the “credit system”, debts are assigned a priority so that lenders understand where they stand on each particular loan. The term creditworthy was created to abstract the morality associated with failing to pay back a debt, so the borrower can still be considered “trustworthy”. But a portion of the loan agreements do not have high creditworthiness. Financial

crises do happen, and borrowers might be fine people, but everybody can find themselves unable to pay a debt from time to time.

A hallmark of a society built on inflationary money is that debt is ubiquitous. It makes sense to borrow money now, use it for something valuable, and pay back your loan in the future with debased money. In a world without bitcoin, this is how people win in the fiat game. You want to be a borrower. Who is the biggest borrower in the world? It is, by far and away, the US government, which has issued close to \$40 trillion of debt. Far in excess of our GDP, there is a zero likelihood of ever paying it back without a significant devaluation of the US dollar. The next largest borrower in the world is Japan, with approximately \$10 trillion of debt. Amazingly, it is large governments that find themselves in the most privileged position of borrowing. A few more countries, like China and the UK, are also large borrowers, but they all pale in comparison to the US. To be clear, we're only talking about debt that the US has issued to other people through the sale of bonds. If we included unfunded liabilities like the large entitlement programs, such as Social Security, Medicare, and government pensions, we would be looking at a staggering amount exceeding \$200 trillion. It becomes quite obvious when seeing the numbers that there is simply no possibility of honoring these loans.

Governments don't hoard all of the borrowing benefits for themselves. They allow consumers to participate in the

borrowing and encourage it. Mortgage lending, for example, enables people to borrow to buy their homes. This is done through government agencies like Fannie Mae and Freddie Mac to the tune of \$7 trillion, as well as through commercial lenders. It isn't altruistic by any means. These government agencies end up feeding the beast of lenders to the US government, typically buying US Government bonds to back their loans. Think of this as a way for the US government to find new lenders using agencies to intermediate between them and the millions of individual consumers borrowing from them.

This playbook is replicated with auto loans (approx. \$2 trillion) through lending to corporations instead of government entities. The three largest nonfinancial corporate borrowers in the world are auto companies — Volkswagen, Toyota, and Ford Motors — who sell corporate bonds to then issue loans for people to afford their cars. Other companies incur debt to finance mergers and acquisitions, or just good old-fashioned growth. The total debt between the top three is about \$700b, a far cry from any G20 government. Additionally, there's an agency debt program for student loans, which are irrevocable. The current outstanding debt for US student loans is just under \$2 trillion, exceeding the debt issued in total by Spain and Australia.