Effect of government debt on incentives for money creation

- Abdullahi Ahmad

Why might the level of government debt affect the government incentive regarding to money creation.

Government debt(also known aspublic debtandnational debt) is thedebtowed by acentral government. Government debt is one method of financing government operations, but it is not the only method. Governments can also create money tomonetizetheir debts, thereby removing the need to pay interest. But this practice simply reduces government interest costs rather than truly cancelling government debt, and can result inhyperinflationif used unsparingly. Public debt is one result of government financing expenditures. It is different from private debt, which consists of the obligations of individuals, businesses, andnongovernmental organizations. Public debt comes about as a result of taxing and borrowing by the federal government. The U. S. government has large capital outlays for such purposes as building or improving schools, hospitals, and highways. In order to pay for these projects, the government must finance part of their expenditures. When a government borrows money it also avoids the excessive tax burden that such payments would involve in a single tax period. Public borrowing is generally believed to have an inflationary effect on the economy and for that reason is often resorted to in recessionary periods to stimulate investment, employment, and consumption. The debt owed by national governments is usually referred to as the national debt and is thus distinguished from the public debt of state and local governing bodies. In the United States, bonds issued by states and local governments are known as municipals. In the past, paper money was frequently regarded as a portion of the public debt, but in more recent years money has been regarded as a distinct type of obligation, in part because it is usually no longerpayablein gold, silver, or other specific items ofintrinsic value. Public debt, which is also sometimes referred to asgovernment debt, is all of the money owed at any given time by any branch of the government. It encompasses debt owed by the federal government, the state government, and even the municipal and local government. It is, in effect, an extension of personal debt, since individuals make up the revenue stream of the government. Public debt accrues over time when the government spends more money than it collects in taxation. As a government engages in moredeficitspending, the amount of debt increases. Many different types of debt make up public debt. A great deal of it isexternal debt, which is money that is owed by the government to foreign lenders, either in the form of international organizations, other governments, or groups like sovereign wealth funds, which invest in government bonds. Government debt is also made up ofinternal debt, where citizens and groups within the country lend the government money to continue operating. In some ways, this is a lot like lending to oneself, since ultimately the responsibility for it falls back on the very people lending money.

Government incentive simply means something that motivates an individual to perform an action. The study of incentive structures is central to the study of all economic activities (both in terms of individual decision-making and in terms of cooperation and competition within a larger institutional structure). Economic analysis, then, of the differences between societies (and between different organizations within a society) largely amounts to characterizing the differences inincentive structuresfaced by individuals involved in these collective efforts. Ultimately, incentives aim to provide value for money and contribute to organizational success. incentive is not peculiar to economics alone, it is a general term used in many spheres of life. However, in economics, it is a very important word. In fact you can never study economics successfully without understanding what incentives are. One American economist says that economics in its entirety is a study of people’s response to incentives. Whether that statement is accurate or not is subject to one’s point of view, but what comes out clearly is the fact that incentives are truly central to the study of economics. In economics one can say that an incentive is a benefit, reward, or cost that motivates an economic action. Human beings do things deliberately and purposefully, and, naturally, people expect to benefit from their own decisions and actions. Before someone decides to produce something and sell it to people, they should have taken time to think and decide that doing this will help them earn something. Likewise, before a consumer buys anything, they know (or at least they think) that they are going to benefit from the product. In strict sense, it is more than just the usual concepts or trade and economics, it is about human nature. No one does something for no reason. Not when they have to spend time and resources in doing so. Incentives can be grouped into four main categories, or types. These types of incentives apply both to economics and to other spheres of life. These are as follows,

Financial incentives: Perhaps in the modern times, financial incentives are more dominant. Before you get to business, you know that it is always about profit. Employment is all about salary and remuneration. It is true that sometimes people do voluntary jobs for some reasons other than financial ones. But ultimately, the main reason why human beings do business or work at all in modern days is money . It is this type of incentive that informs the idea of product promotions, where people are told that if they buy a certain product; they stand a chance of winning a certain amount of money.

Moral incentives: Moral incentives motivate people to do things on the basis of right and wrong. People are encouraged to do certain action because morally, it is the right thing to do. Aspects of morality today are quite diverse, varying broadly from one society to the next, and it is practically impossible to define morals of society in general. Moral incentives therefore generally appeal to an individual's own conscience.

Natural incentives: " What will happen if I do this?" We often ask ourselves. Humans are naturally curious creatures, and we do many things for no reason other than to find out what the consequences are.

Coercive incentives: Moral incentives motivate people to do things on the basis of right and wrong. People are encouraged to do certain action because morally, it is the right thing to do. Aspects of morality today are quite diverse, varying broadly from one society to the next, and it is practically impossible to define morals of society in general. Moral incentives therefore generally appeal to an individual's own conscience.

Ineconomics, money creationis the process by which the of a country is increased. Acentral bankmay introduce new money into the economy (termed ' expansionary monetary policy') by purchasingfinancial assetsor lending money to financial institutions. Commercial banklending then multiplies this base money throughfractional reserve banking, which expands the total ofbroad money(cash plusdemand deposits). Also money creation is The process in which banks increase the amount of funds in checkable deposits by using reserves to make loans. Money creation is an important process in the economy because it means that the government does not have total control over the money supply.

In view of the above definition there is a high link between debt and money creation. Therefore, the monetary authority of a nation which is usually the Central Bank helps to effectively creates money by implementing policy through its Open Market Operation. To create money, the Central Bank simply buys government securities such as Treasury Bills, Treasury Certificates and Treasury Bonds from participating banking institutions. All these Treasury securities are bought in the Open Market. These treasury certificates are exchange for money which the commercial bank will have in their possession to give as loans to members of the public and it tends to increase bank credit. Thus, stimulating money creation.

However, money creation could be restricted as government debt increases which could either be as a result of necessity or deliberate, if government as a result of necessity want to borrow money it usually does these through the treasury department under the Central Bank. There for the Treasury Department of a nation, in order to raise cash, will print up a stack of Treasury bonds, which are the means by which the government borrows money, these government debt tends to mop up the supply of money in private banks as central bank do not deal directly with members of the public and thus reducing the ability of commercial bank to lend money. The supply of money could also be restricted by government deliberately by selling treasury certificate at an attractive interest thus limiting the commercial bank ability to give loans and thus create money.

It should be interesting to know that the money created by the government is also created through debt because as it is the money used in buying treasury certificates was a result of monetizing of debt because the money created out of thin air by the Central Bank on behalf of government is a promise to pay without attracting interest. Hence debt is use to pay debt. In this case debt without obligation is used to pay debt with obligation.

Invariably money could be created through debt and as well restricted through debt; it all depends on which form of debt government is using.

If government uses debt with obligations, that is when government sells treasury certificates to raise cash and thus restrict the ability of commercial bank to create money. If however, government uses debt without obligation, that is when the government print money to buy treasury securities and as such enable the commercial bank to increase their lending power. This brings more money to the economy because the commercial bank will be able to give out more loans from the money received from the sale of treasury securities.

So now we know that there are two kinds of money out there.

The first is bank credit, which is money that is loaned into existence, as we saw here. Bank credit is a type of money that comes with an equal and offsetting amount of debt associated with it. Debt upon which interest must be paid.

The first is thatallcash or money of a nationare backed by debt. At the local bank level, all new money is loaned into existence. At the Federal Reserve level, money is simply manufactured out of thin air and then exchanged for interest-paying government debt. In both cases, the money is backed by debt. Debt that pays interest. From this Key Concept, we can formulate a truly profound statement, which is that at a minimum, each year enough new money must be loaned into existence to cover the interest payments on all of the past outstanding debt.

If we flip this slightly, we can say that each year all the outstanding debt must compound by at least the rate of the interest on that debt. Each and every year it must grow by some percentage. Because our debt-based money system is growing by some percentage continually, it is an exponential system by its very design. A corollary of this is that the amount of debt in the system will always exceed the amount of money.

By understanding its design, though, one will be better equipped to understand that the potential range of future outcomes for our economy are not limitless, but rather bounded by the rules of the system.

All of which leads us to the fact that perpetual expansion is a requirement of modern banking . In fact we can make a rule: Each year, new credit (loans) must be made that at least equal the amount of all the outstanding interest payments that year. Without a continuous expansion of the money supply, past debts would not be able to be serviced, and defaults would ripple through, and possibly destroy, the entire system. Defaults are the Achilles heel of a debt-based money system, which we saw in our local banking example in the previous chapter. Because of this, all the institutional and political forces in our society are geared towards avoiding this outcome.

In view of the above money, government debt will help stimulate money creation if only there is more debt without obligation by government as against government debt with obligation. Conclusively, debt is money.