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THE NATURE OF DEBT

WHEN CREDIT IS GIVEN

Debt arises when credit is given. A consideration of debt must therefore start with a consideration of credit.

Credit is the natural expression of trust in a community. Simple communities can work like large families. Mutual help is given willingly and is not considered to be an obligation or debt. As communities develop, there is specialisation as well as co-operation and people produce for sale to others whom they do not meet or know. The range of products and services widens. Individual interests become dominant and the simple society develops into a complex organism in which everything, including labour and land, has a market value. The natural giving and receiving becomes a process of exchanging wealth in the form of goods and services. All wealth put into the market is then valued so that an equivalent value of wealth can be drawn from the market in exchange. Wealth, as distinct from claims on wealth, is defined as the product of work on the natural resources of the earth.

The market economy is an elaborate network of paths by which wealth is transferred from the producer to the consumer. All who are able contribute according to their talents on the assumption that whatever they need will be available in exchange. The foundation is still trust in the community, and this is credit. Individual members of the community are continually giving credit that others are producing whatever wealth is needed. By claiming the credit, each accepts the obligation, or debt, to produce wealth in exchange. It is a mutual credit/debt relationship.

Exchange is rarely immediate. A large and complex project can use the work of many people in many ways over a long period. All those who provide work give credit that the users acknowledge the debt to produce wealth so that when the project is completed and brought into use, the exchange can be completed.

All this activity has to be valued in a mutually acceptable way and money comes into use for the purpose of valuation and as a means of exchange. The way in which money is introduced and used in the economy needs the most careful control.

MONEY

Money is a marvellous mental concept. It need not have any particular form or any intrinsic value provided that it is trusted generally as a symbol or token representing the value of wealth in an uncompleted exchange of wealth. It represents the value of wealth put into exchange (credit) and the value of the obligation to supply wealth in exchange (debt). The use of money is an elegantly simple way of managing a highly complex network of exchange. It can track the constantly varying credit/debt balances arising from the timing of the exchanges of wealth.

When the economy grows by way of long term capital projects and new enterprises generally, the exchange cannot be completed until the new projects are ready and brought into use. Additional money will be needed to register the value of these uncompleted exchanges. It is the function of banks to create the additional money.

The additional money registers both credit and debt. The credit is the value of work on the new enterprise and the debt is the obligation to put the completed project into use to complete the exchange and to repay the bank advance. Similarly, banks may create money as an advance to acquire wealth provided that the borrower agrees to repay the advance from future earnings from the production of wealth to complete the exchange.

The obligation to create wealth to exchange must always be there before a bank advances money on credit. It is the right way to ensure that outstanding debt is kept under control.

It is the creation of money without this prior agreement to create new wealth in exchange that is the cause of the unregulated increase in debt. That additional money gives to the recipient a claim on wealth but the failure to ensure the provision of wealth in exchange leaves the obligation or debt outstanding. This fundamental systemic failure is consistently overlooked. Throughout the ages there have been debt crises caused by providing additional monetary claims on wealth without ensuring that there is a recognised obligation to produce wealth in exchange to discharge the debt. If wealth is claimed without wealth being provided in exchange, the debt remains outstanding. The primary cause of outstanding debt is the creation of additional money as a consequence of the private ownership of land.

LAND AND RENT

As communities grow, trading or living at some locations is more beneficial and those who benefit are willing to pay rent for the right of occupation. This is common knowledge and it is generally agreed to be a reasonable and fair way to give equal opportunity to everyone. The essential principle of a freely negotiated rent on every site is that comparable sites in every location are then left with a similar value for the production of wealth.

The rent of the land is a surplus naturally provided by the presence and work of the community, to meet the cost of communal services provided by government at all levels. Those who provide the communal services do not act directly in the wealth production process and this surplus enables them to claim their share of wealth without penalising those directly involved. It is a simple natural process.

The problem is that this natural surplus is never allowed to work like that. Those who have the power to do so claim ownership of the land and collect the rent. This does not directly affect those occupying and using the land because its rent is an agreed surplus to be contributed by the occupier. But when government is deprived of its natural source of revenue to meet the communal expenses, it must collect an equivalent sum in taxes instead. Taxes are drawn almost entirely from earnings in production of wealth.

The effect is that wealth producers lose in taxes part of the money representing their just claim to wealth in exchange. The rent received on land enables owners to claim wealth without, as landowners, producing any wealth in exchange. Taxation on earnings from the production of wealth is a constant drain on the productive economy. It is the consequence of the private appropriation of the rent of land.

A more pronounced and immediate effect is caused by the sale of land. The advantage of land ownership encourages banks to create additional money as secured credit for the purchase of land, particularly residential property. The new money creates the usual credit and debt. The credit is a claim on wealth gained immediately by the vendor who receives as the sale proceeds the capitalised value of the future rent of the land, theoretically in perpetuity. The purchaser bears the corresponding debt, usually as mortgage repayments over a long period. The additional money (reduced by any debt on the land owed by the vendor) increases the total outstanding debt. Every subsequent sale at a higher price, using new money, enables a vendor to claim the increase in value and adds to the overall level of debt.

The private ownership of land is the primary cause of the growth in debt.

SUBSEQUENT EFFECTS ON DEBT

The need to invest accumulating monetary claims on wealth from the ownership of land brings the financial 'industry'. It uses financial instruments to influence markets for the advantage of the claimants at the expense of those who produce the wealth. The proper use of money is to record an already existing outstanding claim on exchange of wealth. It registers an accepted obligation to complete an exchange of wealth in the productive economy. Money is not intended for use independently as a factor in trading in money. Money used in this way creates new claims on wealth without producing any wealth in exchange. Trading in money transfers wealth from the productive economy to the investors and money traders and further weakens the natural economy.

The growing diversion of claims on wealth towards those who produce no wealth increasingly saps the vigour of the productive economy. Personal borrowing is encouraged to reinvigorate it but any increase in wealth production tends only to increase the outflow in rent while increasing the total debt.

In consequence there is a growing need for government welfare expenditure, which cannot be met from taxation, and the government borrows to meet the deficit. The overall level of debt is again increased.

Finally the central bank steps in to create money as quantitative easing (QE) which it uses to purchase existing government securities. The intention is that the money received by the vendors shall be loaned for capital investment and generally to restore employment in the production of wealth. The increased wealth would then allow for the re-sale of the government securities so that the central bank could cancel the money created as QE. The benefit is limited in practice because banks lend the money more profitably for further investment in landed property and speculation in the money market. The net effect is to increase overall debt and corresponding unearned claims on wealth.

INTEREST

The effect of interest is not considered in detail here but in general interest on bank created money increases the relevant transfers of claims on wealth and the consequent debt.

THE END RESULT

The private ownership of land transfers legitimate claims on wealth (goods and services) from the productive economy and weakens it. It is the primary cause of the widening gulf between the rich and poor. Instead of dealing with the cause of the problem, efforts are made to boost the economy by the introduction of additional money with its credit/debt relationships. This process contravenes the basic natural law, which limits the use of money to that of a token representing an uncompleted exchange of wealth.

The unjust monetary claims on wealth become bank deposits, government securities, pension funds, hedge funds and other loans and investments of all kinds, particularly residential land. Some claims will have been passed to others by gift or legacy. The debts resulting from the additional credit that gave rise to these claims can ultimately be cleared only by work on natural resources to produce wealth to the value of the debt. It is a huge burden on workers in the productive economy continuing to succeeding generations.

The present very high level of debt, comprising both personal and national debt, is the debris of a malfunctioning economic system. Debt burdens of this magnitude in the past have resulted in crises and the result has been a cancellation of debt and the loss of corresponding claims. The essential first step to avoid a similar outcome now, is to eliminate the root cause by gradually restoring the rent of land to the community for its natural use thus reducing the need for the taxation of earnings with its malign effects. The wide repercussions of such a change make it difficult to contemplate.

It will require unprecedented goodwill and understanding to reduce present total debt to an acceptable level, but there is no alternative.