



Economic Affairs Committee

Corrected oral evidence: Sustainability of the UK's national debt

Tuesday 5 March 2024

3 pm

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Members present: Lord Bridges of Headley (The Chair); Lord Blackwell; Lord Burns; Lord Davies of Brixton; Lord Griffiths of Fforestfach; Lord Lamont of Lerwick; Lord Layard; Lord Londesborough; Lord Razzall; Lord Rooker; Lord Turnbull; Baroness Wolf of Dulwich.

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Questions 196 – 211

Witness

[I](#): Joseph Stiglitz, University Professor, Columbia University.

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Examination of witness

Professor Joseph Stiglitz.

Q196 The Chair: Welcome to this session of the Economic Affairs Committee. I am delighted to welcome Professor Joseph Stiglitz, who is joining us from New York. Professor Stiglitz, good afternoon to you.

Professor Joseph Stiglitz: Good morning.

The Chair: Good morning, rather. Thank you very much for joining us here in London on a wet and miserable afternoon. Can I start by asking you to set the scene with a very simple but big question: does debt matter? We have had evidence from certain quarters giving the impression that debt may not matter. What is your view?

Professor Joseph Stiglitz: Debt does matter, both economically, and, perhaps even more, politically. Let me first try to explain MMT, the modern monetary theory, which has argued that it does not matter at all. I also want to make it clear that the view held by many people, that it is the most important thing, is wrong. I am not at all worried about the level of debt in the United States. So the view that we face an existential crisis because of the debt is wrong, but the other view, that we do not have to think about it, is also wrong.

The origin of the view that it does not matter at all goes back to the 2008 financial crisis, where we expanded the base money supply enormously—by fivefold in the US and Europe—and there was no inflation. That led people to believe that you could increase the money supply enormously without any inflationary consequences. There was no inflation, because the money went from the Government into the banks' coffers and they did not lend it, so it did not have any inflationary effect, but it did not have any benefit either.

If that money had gone into the banks, the banks had lent it, and the people to whom it had been lent had spent it, we would have had enormous inflation, but we would not have needed to increase the money supply that much. We kept doing it, because we hoped that increasing the money supply would stimulate the economy, but it had a very weak effect. That is the fallacy in MMT: if you increase the money supply and nobody spends the money, it does not cause a problem, but it does not solve a problem, either.

Q197 The Chair: At what point would you say debt becomes a concern? Could you map out what would keep you awake at night if you think of the word "debt"? When would it be a concern to you?

Professor Joseph Stiglitz: Right now, the debt in the United States has become a political problem, because one of the parties has started worrying about it in a somewhat inconsistent way and using that as an excuse not to make investments we desperately need for the future, including in climate change, health, education, infrastructure and

technology. If one becomes obsessed with the magnitude of the debt, that can impede making important investments.

The US and the UK are in a somewhat different position. You are a relatively smaller, open economy. We are a huge economy. If you borrow large amounts from abroad, that means you will have to pay back that money in the future. If the money you borrowed abroad has not been invested well, there will be a drain out of the standards of living of your citizens to abroad.

On the other hand, if you borrow from abroad and invest it well, the economy's growth is great enough to more than repay the loan. To put it in simple terms, global interest rates have historically been between minus 1% and plus 1.5%. A large range of public investments in infrastructure, technology and many other places yield returns in excess of 10% to 15%. In areas of technology, we have done estimates that put the returns at well in excess of 30%. So if you borrow at 1% and get returns of 30%, the country is richer. Although it has to pay more abroad, it gets more income.

Q198 The Chair: In terms of the immediate future, how concerned do you think the Chancellor, who is giving a budget tomorrow, should be about debt sustainability here in the UK?

Professor Joseph Stiglitz: That is not the priority issue. The priority issue is investments to sustain the economy. The UK has really been suffering from a lack of productivity. That is the major thing I would focus on. If you can use the borrowing to increase productivity, it is money well spent.

Q199 Lord Griffiths of Fforestfach: What is the optimal size of the state in terms of total spending, and what particularly is the size of investment within that, which you rightly draw attention to, as distinguished from whatever you think the size of the state is? If the debt is, let us say, 100% plus the size of the state, and you are concerned about the possibility of living in a world of radical uncertainty where you have pandemics, wars and supply-side shocks, do you not need a sufficient amount of potential behind you—a lower ratio of debt to income—in order to pursue a prudent economic policy?

Professor Joseph Stiglitz: There is no magic number on the relative size of the state. It changes with economic circumstances. Many of the changes in our world in the last 20 years necessitate a much larger size of state than 40 to 50 years ago.

Climate change is a major externality and an existential threat. As a society, we have to spend a lot more to combat this war against nature. The private sector on its own is not doing enough, so we will have to spend a lot.

The new technologies have highlighted the importance of basic R&D that has to be done by the Government. If you were in a primitive agricultural agrarian economy 200 years ago, R&D was not so important, but it is

today. Those are just two changes that necessitate a greater role of the state than was the case in earlier decades.

The last point you made is one I very strongly support: if we live in a world with high levels of deep and radical uncertainty, we have to have more buffers, and we have to be able to respond. This again relates to the politics: if there are worries about the level of debt, and those worries lead to constrained spending, in the event of exigencies—like the pandemic we just went through—we want to have the capacity to respond to those strongly. I would hate to have the strength of our political response hampered by the existence of too high a debt.

Q200 Lord Griffiths of Fforestfach: We have taken quite a lot of evidence on fiscal rules, and I think it was Olivier Blanchard who said, “Some people advocate simple rules, but somehow they’re never nearly simple enough. Others advocate complex rules: they’re never complex enough”. What are your feelings about fiscal rules?

Professor Joseph Stiglitz: I have written a paper with Bob Rubin, who was the Secretary of the Treasury when I was in the Clinton Administration, and Peter Orszag, who was the head of the OMB in the Obama Administration, where we expressed some scepticism over the top-down rules, such as those in Europe, restricting the level of deficit and debts, precisely because of the importance of the unpredictability and radical uncertainty.

Whatever the rule, events will happen that necessitate breaking the rules, which will undermine the credibility of the rules themselves. One might have targets and focal points, but with a very clear understanding that those will have to be put aside if you have a pandemic or a war.

The kinds of rules imposed by the EU are poorly designed, particularly the 3% deficit, which does not take account of how the money is spent. In my first set of remarks, I emphasised that borrowing money for productive investment is very different from spending money on consumption. That 3% rule is tying the hands of many countries’ ability to make investments, including green investments that will be very important for the green transition.

Q201 The Chair: Professor Stiglitz, just to get you on the record on this, do you think the current UK fiscal rule should be ditched?

Professor Joseph Stiglitz: You will have to remind me of the articulation of the current rule.

The Chair: The current UK primary fiscal rule is that debt should be forecast to fall as a share of national income between the fourth and fifth years of the five-year forecast period.

Professor Joseph Stiglitz: A rigid rule like that is not helpful. Any rule has to pay attention to how the money is spent and the circumstances of the country at that particular juncture.

Q202 Lord Layard: You have been stressing the importance of how the money is spent, but do you have a general definition of what is a sustainable or unsustainable debt level, or do you think it is a useful concept?

Professor Joseph Stiglitz: In economics, there is a very strong notion that, if the interest rate is high relative to the rate of growth of the economy, debt may become unsustainable. If you have a 100% debt-to-GDP ratio, you have to pay a high interest rate, and if the growth is low enough that you could not grow out of that debt, you will have a problem.

Going back to the end of World War II, the UK had a high debt-to-GDP ratio, but the growth rate was exceeding the interest rate, so it came down. The same thing was true in the United States; I believe we ended the war with a 135% debt-to-GDP ratio, but the growth rate exceeded the interest rate, and that level of debt relative to GDP came down. In assessing debt sustainability, the relationship between the interest rate and the growth rate is a key variable that one needs to look at.

Q203 Lord Lamont of Lerwick: Good afternoon, Professor Stiglitz. You made the point that it is possible to borrow money at very low or negative rates of interest, and that investment projects, particularly infrastructure, might return over 10%. I want to explore the meaning of the word investment. First, is the distinction between investment and current spending always crystal clear? Are these watertight definitions? Is investment in nurses' pay current or investment spending?

Secondly, when looking at environmental or health investments, how easy is it to measure the returns in advance rather than post hoc? I do not doubt that they are a public good and contribute to well-being, but one has to have a mechanism to distinguish one investment from another. How easy is that to do?

Professor Joseph Stiglitz: That is a very good question, and the answer is that it is not always easy to make clear distinctions. When I was in the Clinton Administration, we struggled with precisely that issue in the context of capital budgeting. The conceptual framework is very clear: spending that increases output, productivity and well-being in the future is an investment. Spending today where the return occurs in the future is an investment. There are many categories of spending where that is the case: you build a road and it is there for 30 to 40 years, you build a power plant, you make an R&D expenditure, you make an investment in the health or education of a child. This is spending for which the full return will occur in the future.

There is no doubt that these are capital expenditures. Like any spending, there is uncertainty about what the returns will be. That is true of current spending, as well as future spending through investment. We always have to ascertain how well the money is spent, and when we make decisions concerning the future, the uncertainty of necessity is greater.

We have a wealth of experience in many of these areas. We have data that will show the average returns on expenditures on technology in the

past, for instance, and if we maintain appropriate systems of selection, monitoring and institutional arrangements, there is no reason to expect a lower return. It is not for sure, but that is the nature of any spending: you look at the past and try to improve your procedures to get even better, higher returns.

I agree with the final point you raise. The boundaries are fussy. You gave an example of raising nurses' wages. If that results in the ability to hire more nurses—or more able nurses—and that leads to better healthcare, which leads to a healthier population, that is an investment. We do not have to be nitpicking over these boundaries. There are enough good investments to justify undertaking more debt today that we can focus our analysis of debt and whether it is worth undertaking the debt simply on the more obviously productive investments.

Q204 Lord Davies of Brixton: We have talked about where we are and what is sustainable. Do you have concerns about the future path of debts over the next 10, 20, 30 years? Focusing on G7 economies, are you worried about where they are going? There are particular problems in the States.

Professor Joseph Stiglitz: The current anxiety is a result of the debt accumulated during the pandemic, an unusual set of circumstances. All the G7 Governments responded to the pandemic with force, and the result was that we avoided a deep recession and depression. It was money well spent. We protected vulnerable people against absolutely disastrous outcomes, and we managed to develop a vaccine in record time. That sudden increase in the debt-to-GDP ratio was money well spent, and I really have no regrets about that increase in debt.

We are now back on a more normal course, if you put aside a couple of wars going on, which hopefully will be resolved soon. There will be a need to have greater spending on defence in Europe, and that will necessitate a closer look at other forms of expenditure. In the United States, there is a recognition on the part of the Democratic Party that more progressive and better-designed taxation could significantly increase tax revenue and improve the performance of the economy, that our tax structure overall is not very progressive—in fact, at the top, it is regressive—that we need a whole range of environmental taxes, that there are large loopholes and extensive tax avoidance, and that market power has increased enormously. Appropriating some of that monopoly profit or rent for public purposes would decrease rent-seeking and not have an adverse effect on investment or employment.

If the Democratic Party gets elected with a sufficient majority, there will be enough tax revenue to undertake the investments we need without the encumbrance of additional debt. On the other side, what worries me is that Republicans are likely to curtail not only debt finance but also investment, which will lead to a much weaker economy in the future.

Lord Davies of Brixton: So is it all about the politics.

Professor Joseph Stiglitz: Yes, very much so.

Q205 Lord Davies of Brixton: Are there any insights from the past about how this will go over the next period of time? People want to point to what happened after the Second World War, where we managed incredibly high levels of debt, but are we in a totally new situation where new rules will apply?

Professor Joseph Stiglitz: Not really. The remark I made earlier is pivotal: the focus should be on whether you can get a higher growth rate. There are good reasons to believe that we can have growth rates significantly higher than the rate of interest if we make investments in green technologies and the very powerful new technologies that are coming on board.

Some people believe changing demography will lead to higher real interest rates. I am not on that side. I have seen no inclination for interest rates to rise. It may be true in 30 or 40 years, but I have seen no evidence of significant secular trends in the real rate of interest that would reflect the demographic changes that are occurring. I am not worried about a significant increase in the real interest rates in the next couple of decades.

We have to admit that nominal interest rates can fluctuate. We can have episodes of inflation, as we have gone through just now, but it is worth noting how quickly that returned to a more normal level and that long-term real interest rates did not change a great deal.

Lord Davies of Brixton: Would you hazard to advise on what counts as a normal rate of interest?

Professor Joseph Stiglitz: As I said, historically, the normal real interest rate has been in the range of minus 1% and plus 1.5%. Recently, we have had a more extensive period where real interest rates have been negative. That goes the other way from those who worry about there being very high, positive real interest rates. There has been a downward secular trend in the real interest rate, and I see no evidence of a significant turnaround over the next 20 years that would lead me to be very worried.

Q206 The Chair: We have been talking for about half an hour now. You are sitting in the States, we are sitting here in London, and I am getting a sense that you are saying debt sustainability is not the issue others might have told us it has been. What I am hearing is quite Panglossian. Maybe you can tell me I am being too depressing and seeing the glass as half empty whereas it should be half full, but is there a sense you are looking at this very much through the lens of the US and not the UK and the challenges we face of flatlining growth, very poor levels of productivity, and the numerous other issues regarding productivity, particularly in public services, et cetera? The US is a powerhouse that sadly, at the moment, the UK cannot claim to be, although we would all like it to be.

Professor Joseph Stiglitz: You may be denigrating your capacities more than you should. One of the major advances driving technology is artificial intelligence, and you have to give credit to DeepMind, a British

company that was really one of the major sources of AI. An awful lot of innovation is going on in the UK. It is not news that productivity overall has not been great in the UK, as I mentioned before, which brings me back to what I said: that to cut back on the investments necessary to restore productivity would be a disaster. The priority is to make sure that you make the investments necessary for enhancing productivity and therefore growth.

The argument I made for the United States is almost surely true for the UK, but I have not studied that. There is scope for better-designed taxation that would provide for an alternative to debt finance if you could tax the monopolies. You did something I strongly tried and failed to get President Biden to do: the windfall profits tax in the aftermath of the Russian invasion of Ukraine that led to high oil prices. That kind of windfall profits tax is an example of raising revenue with no or little adverse effects on employment or investment. If you have a better-designed, efficient tax system, you can raise revenue in a non-distortionary way and therefore be less reliant on debt finance. If I were in the UK, I would be arguing for that more vehemently.

Q207 Baroness Wolf of Dulwich: I was going to ask about your expectations for interest rates, but you already said that you do not expect there to be any major change in the long-term real interest rate.

So I have two questions. First, could you elaborate a little on why you think we are not in any sort of new world where that is concerned? You said that you do not think that demographics will make any difference, but could you also elaborate a bit more on why you think we will have the same stable long-term rate as historically?

Secondly, given that, I think we all agree, we are in a world where there are lots of sources of instability that may have an impact on nominal rates, does a period of likely continuing instability at that level have any implications for debt management and debt sustainability?

Professor Joseph Stiglitz: Let me begin with the second question. I have argued that deep uncertainty—the fact that we do not know—calls for a variety of more precautionary behaviours. For instance, in the period when interest rates were close to zero, I argued that it made sense for Governments to extend the maturity structure of their debt so that, if interest rates went up, they would at least have a long period to adjust as the debt rolled over. My country did not do that, which I thought was a mistake and makes us much more vulnerable to changes in the nominal interest rate. That is an example of the kind of precautionary behaviour one wants to take.

In this world with a lot more volatility, I have also argued that one of the kinds of precautionary behaviours is extending the automatic stabilisers that help stabilise the economy. One way of doing that is to think about more flexibility in investment expenditures so that you have a five to 10-year plan for investments and infrastructure. When the economy is weak those investments are brought forward, and when the economy is very strong they are delayed, so you use that capacity of fiscal policy to help

stabilise the economy and get your investment in at the right time, thus combining short-term macro with long-term growth strategy. Those are examples of the way we ought to be thinking more about how we respond to radical uncertainty—the deep uncertainties we face—both on the inflationary side and the real side.

Regarding the basis of my belief that real interest rates are likely to remain unchanged, I first have to admit that events that we have not anticipated can occur that could change that, but the real interest rates have remained remarkably stable over a very long period with a secular downward trend. Over that long period, lots of big events have interfered with the economy. The forces that determine the real interest rate, which include the Government's conduct of monetary policy, have been able to keep the real interest rate within a remarkably narrow band.

I have looked at the arguments put forward for why we might be expecting an increase in real interest rates, and I have not found them that persuasive. There are counterarguments on the other side and I have not seen evidence of them appearing, but it is worth paying attention to those possibilities, because we all work with a cloudy crystal ball.

Q208 Lord Blackwell: Can I take you back to the link you made between borrowing and investment in a global economy? We are talking about public sector investment, not the totality of investment. In a closed economy operating at full capacity, more public sector investment presumably has to displace either private sector investment or consumption. You made the case that if you can borrow from abroad and invest it, it would return higher than the interest rate. That is a good deal, but the sums would not add up in a world where every country was borrowing from overseas to invest. Are we in a situation where we are very reliant, and potentially unstably reliant, on a few countries providing a surplus to fund investment? In a global society, how does your recipe for borrowing from abroad to invest work?

Professor Joseph Stiglitz: Right now, and for the foreseeable future, there will be countries running surpluses and lending, so that is a good question. If everybody were in the same position, who would they borrow from? But we are not in the same position; different countries are in different stages of their development strategy, and they have different economic models. Historically, Germany, Japan, and China have had consumption significantly less than their GDP. They are running surpluses and looking for places to lend their money.

From a global point of view, there is a big problem: because of global volatility, which may be getting even greater, countries like to hold reserves. As their economies grow, they put more into reserves just to match the growth of the economy. If volatility goes up, they put even more into reserves. You can think of reserves as savings, as taking current income and burying it in the ground, not spending it, which decreases global aggregate demand and creates a deficiency in aggregate demand. You were talking about a world in which the global economy was

at full employment. The global economy has not been at full employment most of the time.

The issue I just raised about the insufficiency of global aggregate demand because of an increase in reserve holdings was precisely the question that Lord Keynes was worried about when he argued for the creation of what is now referred to as SDRs, special drawing rights, which is a mechanism by which the global economy can adjust global aggregate demand to ensure that we are as close as possible to global full employment.

Q209 Lord Blackwell: For the reasons you say, if the recipe of borrowing to invest is sustainable, it makes sense. But if you take the projections in the UK, where a lot of social and health care is publicly funded, the projections for future expenditure going up as a per cent of GDP with demographics are not about investment; they are about current spending. Does that create a cause for concern about the sustainability of the tax level and the debt to support that?

Professor Joseph Stiglitz: The expenditures, particularly on the aged, which, as demographics change, will be a larger fraction of the population, are a concern everywhere in the world, particularly healthcare expenditures. There is scope for increasing the efficiencies in most countries of the healthcare system in ways that improve performance in health, which is what you care about. One has to think more holistically, recognising that the medical care system is only one part of our healthcare system; mental health and nutrition are also important.

This is an area where I may be overly influenced by the United States. Our largely private healthcare system has been a disaster. We spend close to 20% of GDP on healthcare of our high per capita income, and we get a life expectancy and other health indicators at the bottom of the OECD. That is because of the extraordinary rent-seeking on the part of our insurance companies, pharmaceutical companies, and hospitals. There is a growing consensus in the United States that the private model does not work, but investments in health do pay off.

Q210 Lord Burns: It is often said that the UK would like to have European levels of public services but US levels of taxation. Do you have a view about the point at which the overall tax take has a detrimental impact on growth, and how far does that depend on the particular taxes one puts in place?

Professor Joseph Stiglitz: Your last point is crucial; the particular form of taxation is central. For instance, I very strongly believe a corporate profits tax is a tax on close to pure corporate profits, particularly the way we designed it in the United States, where there is full deduction of capital investment, labour and intermediate costs. We know that increasing a tax on pure profits does not distort investment or employment, so raising that tax would be an important source of revenue that would have little to no adverse effect. In fact, if it is designed right, it could have a positive effect on the economy.

We have other provisions in our taxation where a very large fraction of capital gains escapes taxation, and the rest of it pays a substantially lower tax than other forms of returns on capital, let alone other forms of income. In almost every country there is substantial scope for raising tax revenues in ways that are good for the economy.

Another example is the carbon tax, which discourages pollution and encourages investment for the green transition. It stimulates the economy, makes a more dynamic economy and raises revenue. That is a case where more taxation is a good thing, not a bad thing. If you think deeply about where there are externalities—market failures, rent-seeking, imperfect competition—there is a wide array of possibilities for raising more tax revenue and improving the performance of the economy.

Q211 Lord Burns: Where would property taxes fit into your categories?

Professor Joseph Stiglitz: I would distinguish land taxes from property more generally and I would tax land at a very high rate. In American economics, Henry George argued you should tax land itself at a very high rate. I wrote a paper almost 50 years ago arguing that a land tax was a good basis for a source of raising revenue. I have just finished writing another paper arguing that there is greater potential for productivity growth by encouraging more investment in productive sectors like R&D and new technology sectors rather than in real estate.

One reason why the UK may have had slow productivity growth is a disproportionate share of the investment in real estate. The spillovers from learning in real estate to the rest of the sectors are very limited. On the other hand, the kinds of innovations that occur in the technology sector have enormous spillovers for the entire economy. Policies that tilt the economy away from real estate investment are good industrial policies.

The Chair: I am very conscious of time, and I think you have a hard stop very shortly, Professor Stiglitz. Unless anyone has any final questions, we will end it there. Thank you very much indeed for joining us from New York. We are very grateful.

Professor Joseph Stiglitz: Thank you.