The Open University

Understanding debt in two minutes

Part 1 and 2

Narrator:

Understanding debt in two minutes. Part one, private debt. People and businesses take on private debt because they want to buy something today and pay for it in the future. For example, buying a home or factory with a loan gives people access to a property before they generate the income to pay for it. And in this case, the building itself can be used as security to be seized if the borrower doesn't repay the lender. This is widely seen as good debt, as everybody benefits. But if, for example, property prices fall, and the security is worth less than the loan, as happened before the crash of 2008, and if the borrower doesn't have the income to repay, it becomes bad debt, where somebody is bound to lose out. People on low income needing to borrow for current consumption, like food, can rarely offer any security and with such a high risk of a bad debt, rates of interest on so-called "pay day loans", for example, can be massive. Debt often gets a bad name, but nearly all innovation, art, medicine and food production requires up-front spending before income can be achieved. And it's debt that can help people without wealth to create some.

Part two, public debt. Public debt is essentially the government's overdraft, the total amount borrowed which is still outstanding. Governments borrow to spread the cost of current projects across future years. And hope to achieve long term benefits for their future populations, solve medium term fluctuations in their economic activity, and fix short term economic crises. And because governments don't retire or die, and particularly as big governments already own a lot of assets for security and can always increase their income by raising taxes from the private sector, they are seen as credit-worthy and trusted to borrow large sums over long periods of time, by issuing bonds and hoping that future growth or indeed inflation will reduce their debt over time. So even with massive debts, the United States government is able to keep on borrowing, while smaller countries require the support of development banks and back-up from aid agencies such as the IMF if they are going to borrow anything at all.