THE ECONOMY OF INDEBTEDNESS

Lucian C. IONESCU[5]

Abstract

The hypertrophy of speculative monetary and financial flows has gravely impeded the normal evolution of the real economy, exacerbating the problem of indebtedness world-wide.

Some of the most important ideas of Keynes and Minsky have been selected and re-interpreted in the light of the mentioned rupture. The two types of Minsky's instability hypothesis – ascendant and descendent – have been correlated with the evolution of long cycles. Total debt (public and private) has been analyzed (proportions and structure) in connection with new forms of 'primitive' accumulation and rent which have introduced a *neo-feudal* component in the functioning of today's capitalist system, aggravated by the mankind's damaging ecological footprint.

The debt problem has a serious impact on the economic convergence in the European Union (nominal and real indicators). Suggestions regarding central banking and government/public sector investment policy have been included in the final part of the paper.

Key words: total debt; indebtedness; nominal economy; international crisis; financial instability hypothesis; new 'primitive' accumulation.

JEL classification: A1, B1, B2, E3.

The crisis that burst in 2007/08 had a devastating impact on international monetary & financial system. However it has also had a stimulating effect on a better understanding of the roots of instability and vulnerability of the present world economy.

The breakdown of the totalitarian socialist system (of the Soviet type) at the end of the 1980s contributed to a tendency to idealize the economy based on capital reproduction, by eluding any serious critical analysis of its functioning.

Nevertheless the amplitude of the crisis and its aftermath has overwhelmingly confirmed the Minskyan *financial instability hypothesis,* which until recently was mostly ignored.

In Minsky's vision, *instability* is an inherent and unavoidable drawback of capitalism: "The financial instability hypothesis is a model of a capitalist economy which does not rely upon exogenous shocks to generate business cycles of varying severity."(H.P.Minsky, May 1992, p.8). He emphatically identified the roots of his conception in Keynes's G*eneral Theory,* especially in the Keynesian meaning of the 'veil of money'. Consequently, Minsky's valuable contributions to economics & political economy have signalized a 'return' to the original Keynesian message.

From Keynes to Minsky

It is known that the so-called *neoclassical synthesis* had contradictory effects on the interpretation of Keynesian heritage: on the one hand, it has made easier the assimilation of neo-Keynesist ideas & principles by the 'establishment' but, on the other hand, it has at least partially emasculated the genuine Keynesian analysis of the capitalist economy and society.

Explaining the nature of the 1930s depression, it has been relevant that John M. Keynes deeply dealt with the delimitation of *speculation* (speculative financial operations) from *enterprise* (productive investment). For the former, it is characteristic the obsessive target of acquiring profits by speculating on different forms of liquidity (mainly in the short run), while the latter involves a long term vision and strategy. Although it may seem paradoxical, "as the organization of investment markets improves, the risk of the predominance of speculation does, however, increase." (J.M.Keynes, 1997, p.158). Keynes warned of the danger that capital development, as a factor of production, could become "a by-product of the activities of a casino", affecting the functions of stock exchanges themselves. Therefore, "the measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment

[5] Institute for Studies on Finance and Banking, Bucharest, Romania

into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of *laissez-faire* capitalism…" (op.cit., p.159).

The Keynesian assertion was completely acknowledged by the dramatic consequences of the aggressive de-regulation campaign advocated by the neoliberalism during 1980s & 1990s. Exacerbating the 'autonomy' of the *nominal* economy (that is monetary, banking and financial flows and assets, up to 'derivatives') versus the evolution of the *real* economy (factors of production, goods & services) has represented the basic cause of the crisis phenomena in the last decade, including the present stagnant and recessionary profile of the economic evolution[6].

Due to the global expansion of the giant trans- & multinational corporations, detaining oligopolistic and even monopolistic positions, favoured by *credit and electronic money* proliferation, monetary, financial and foreign exchange speculation have ever more become an aim *per se*, moving gradually away from the trends and necessities of the real economy.

The rupture between the nominal and real dimensions of the economic activity is ambivalent, distorting both the national & international monetary systems and the factors of production markets. Despite the 'generalization' trend of capitalist economic and social model, the nominal /real rift has inoculated a *neo-feudal* element in the societal structure: various forms of the rent and rent-seeking. According to the Keynesian vision, in the economy based on capital, 'normally' there should have taken place "the euthanasia of the rentier, of the functionless investor" (Keynes, 1997, p.376). The replacement would have been evolving 'gradually', so that a revolution would have been 'useless': however that 'normal' replacement took place only partially and new types of 'functionless investors' appeared.

This failure has not been a historical 'accident'. It is intimately linked to an economic and social process specific to the mode of production founded on capital and which, in the 19-th century terminology (especially the Marxist orientation), was called the *primitive accumulation.* In James Glassman's phrasing, "though primitive accumulation is a process that some have considered a historical phase through which societies pass on the way to … social structures based on expanded reproduction, the current state of global affairs makes it evident that it is in fact central to capitalist accumulation in general or else has a much longer period of historical 'dissolution' than previously imagined."("Progress in Human Geography", 30, 5/2006, pp. 621/622). Nowadays, the main financial & monetary markets are overwhelmingly influenced by powerful speculators, the so-called *initiates* – to use J.Attali's terminology.

Total debt management during long cycles

The postwar economic reconstruction tended to re-establish the necessary correlation between the real and nominal flows of the economic circuit. The disintegration of colonial empires and acceleration of international economic growth contributed to a diminishing role of various types of rent and speculative financial flows, while productive capital assets grew in importance. This tendency would last about two and a half decades (until mid-1970s), corresponding to the ascendant phase of the postwar long cycle. Although Minsky's theory was applied especially to the mid-term or 'decennial' business cycles, his ideas are obviously seminal for explaining and understanding the causality of long term cycles (e.g. the Kondratiev type).The economic cyclical movement was one of my main research topics during some decades, so I have proposed the following periodization regarding the long cycles of the 20-th & 21-st centuries, made up of a descending/stagnant stage and an ascendant/expansionary stage: descending stage – 1929/30 until 1944/45; expansionary stage – 1946/47 until 1971/72; stagnant stage – 1973/74 until 1990/91; ascendant stage – 1992/93 until 2006/07; descending stage – 2007/08 until about 2020.[7]

In his fundamental work – "Stabilizing an unstable economy", Minsky depicted the double meaning of the *instability* as a key concept for his theoretical system: a descending instability (crisis/recession/deflation) followed by an ascendant (exuberant/inflationary) instability which, at its turn, provokes another speculative boom that would finally bust. Even if this approach brings a meaningful insight for understanding mid-term business cycles, it has a more profound and complex

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[6] I remarked this danger in the early 1990s and I developed this thesis in different studies and articles (e.g. the study published in "*Financial Studies*", no.3/2013).

[7] L.C.Ionescu, "Interdependence between monetary and real economy in the context of the international financial crisis", in UFB REVIEW, no.1/2011

contribution to revealing the nature of long-term cycles: “The theoretical argument of the instability hypothesis starts from the characterization of the economy as a capitalist economy with expensive capital assets and a complex sophisticated financial system.”(H.P.Minsky, May 1992, p.2).

After the ascendant part of the first postwar long cycle, the ‘oil shocks’ of 1973/74 and 1978/79, including the adjacent recessions, marked the prerequisite for a broader and deeper rift between the real and nominal sides of the socio-economic activity: there is not a mere coincidence that the ‘de-regulation & liberalization’ crusade took place during the 1980s and 1990s. Despite the neoliberal propagandistic terminology, this process acted as an incentive for the expansion of a ‘neo-feudal element’, essentially due to the fact that ‘free competition’ has ever more been replaced by oligopolistic and monopolistic structures. Moreover, since the mid- 1980s the earth’s peoples have been using more of the planet’s resource production each year than could be regenerated in that year: “the ecological footprint of global society has overshot the earth’s capacity to provide.”(Donella Meadows, Jorgen Randers, Dennis Meadows, 2004, p.3). The ‘global’ human society would need about 1.5 planets (of the Terra type) to meet its consuming necessities & habits, leaving aside the huge discrepancies among countries and social categories. In fact, at present, the neo-primitive/barbarian accumulation gravely affects ‘mother nature’ and implicitly the life environment on our planet.

This intricate phenomenon has been affecting the evolution of the real economy and, at the same time, has provoked the recrudescence and multiplication of different kinds of socio-economic and political rent & rent-seeking, among which a conspicuous component, in our interpretation, consists in the insidious increase of debts almost all over the world. Historically, total debt tended to grow during the descending or stagnant stages of the long cycles and to decrease (at least relatively) along the ascendant stages. Yet, in the last two decades, a *structural deterioration* has become obvious: the proportion of the total debt has been continuously amplifying – only its growth rate has varied (in time or from country to country).

In this context, the real/nominal dichotomy has been perverting the normal economic circuit by diminishing the role of productive investment strategy in favour of the *debt management*. As Minsky formulated, “the financial instability hypothesis, therefore, is a theory of the impact of debt on system behavior and also incorporates the manner in which the debt is validated”, but “whether or not liabilities are validated depends on investment” (Minsky, May 1992, p.6). Therefore the financial crises have ever more preceded profound economic imbalances – the most eloquent manifestation of nominal/real rift in the economy.

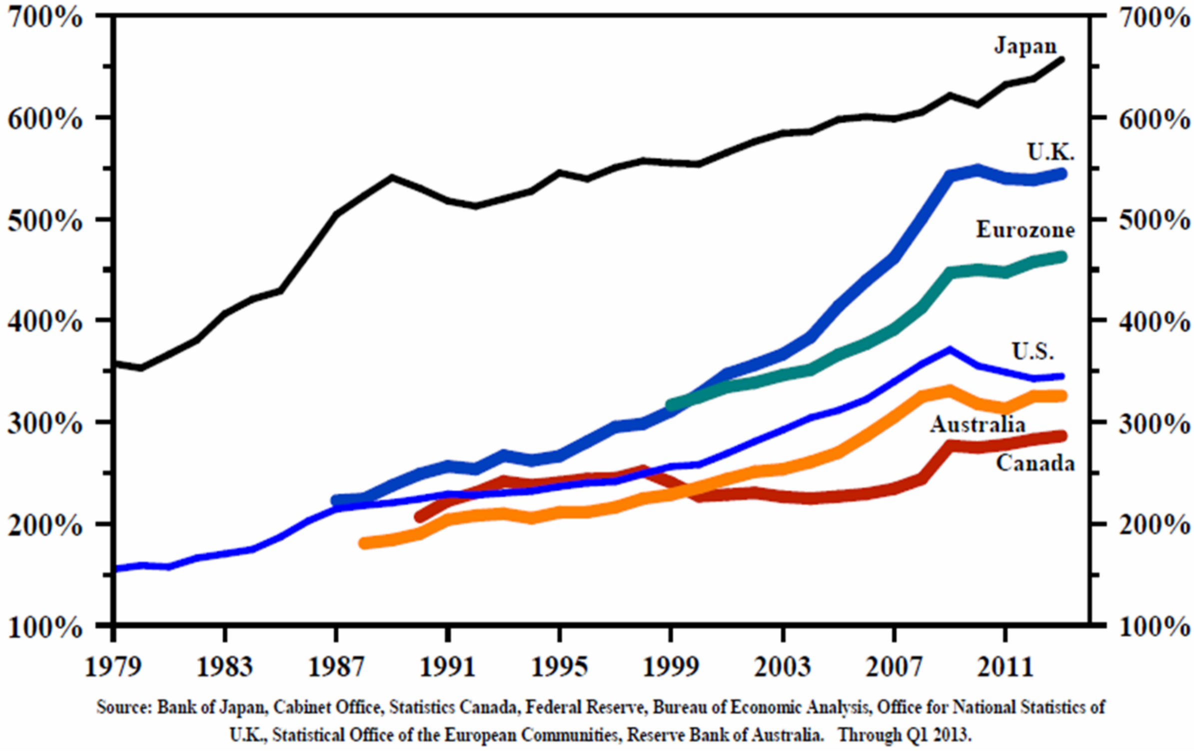

Figure 1. Total Private and Public Debt as a % of GDP. Major Countries (annual)

Consequently a troublesome characteristic of the contemporary world economy has been the *tremendous increase of different categories of debt in most countries*. A significant example is represented by the *total debt*[8] of the ten largest developed mature economies which has been standing at almost 350 % of their GDP in the last years (*Global Finance,* the 2012-14 collection). Here are some examples (TIME, the 2012 collection), in a decreasing order (between brackets the government or public debt share, from IMF, WEO database April 2012): Japan – 512% (235.8), UK – 507% (88.4), Spain – 363% (79), France – 346% (89), Italy – 314% (123.4), USA – 279% (106.6), Germany – 278% (79), Canada – 276% (84.7). Moreover, the tendency of an increasing total debt has been preserved in the years to follow (2013/14). The US economy is presenting a striking case where public (government & intergovernmental) debt has exceeded the GDP, for the first time since the end of World War II (when it stood at 113%). In the postwar period, it slowly diminished until the last 1970s, then increased rapidly again, flattened somehow during the 1990s (while the 'New economy' was hailed) and clearly worsened in the 2000s, especially after the crisis burst out.

Under these circumstances, IMF, World Bank and European Commission (EC) focused on the stringent necessity of decreasing public/government debt, starting with tough limits for government budget deficit (a maximum 3% of GDP for EU countries), irrespective of the level of development of the countries analyzed. Unfortunately private debt did not receive the same attention. In a capitalist economy, government debt is, in most cases, a 'mirror' of the nature, structure and proportions of the private debt. If we are referring to US – still the most important western economy, it is evident that the government debt had a pronounced countercyclical evolution, but with an ascendant long-term trend since early 1980s. This tendency reveals that public debt is approaching its upper torelable limits in correlation with an unhealthy augmentation of private debt (particularly that of financial institutions).

This dangerous propensity is recently confirmed by the continuous increase of total debt. Thus, after about two years (since 2012), total debt has exceeded 600% of Japan's GDP: even if the so-called "austerity measures may have managed to create (more) budgetary discipline, but without a resolution of private debt there is little hope of avoiding the Japanese scenario of low growth, deflation flirts and stubbornly high unemployment."[9]

Beside excessive bureaucratic or corrupted expenditures ('crony capitalism'), the magnitude of government debt reflects specific traits of an economy based on private dominant capital: bailouts - especially for financial institutions considered 'too big to fail' - and the tendency of huge corporations to ignore or at least to minimize *their social and ecological responsibilities*.

Debt and dilemma of economic convergence in EU

This complex situation draws again the attention on the nominal/real disruption in the economy. Such a dysfunction can be also traced in the original form of the *Treaty on the European Union* (the Maastricht Treaty, enacted in 1993), where only the *nominal criteria* were expressly mentioned for adopting the single currency (Euro) by the EU member states, while the *real convergence* was considered simply as background. The dramatic events of the last decade (mainly the international financial crisis and its effects on economy) have revealed the decisive importance of a close correlation between the nominal & real criteria for achieving economic convergence, vital for building up an efficient *economic and monetary union* (EMU). According to the Maastricht Treaty, only the government/public debt was limited to 60% of a member country's GDP (including some significant 'exceptions').

Paradoxically, after more than a decade since the Euro has become the 'single currency' for EU member states (presently 18 countries out of the 28 members), the Euro-area's average government debt has exceeded the average for the whole European Union – over 90% vs. 85.9% (data for 2013), marking a worsening trend (over 87% and, respectively, 83.3 in 2012). Moreover, *private debt in EU represents more than twice the size of sovereign debt.*

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[8] Total debt is including public debt (mainly government debt) and private debt (financial institutions, non-financial businesses, households).

[9] M.Canoy, R.Fransman in "*Pieria*", March 26, 2014

Figure 2. Euro Area Government Debt to GDP

As long as the two basic dimensions of the EU economic convergence – nominal and real – would evolve de-synchronized or even in contrast, *euro* would risk being a vehicle for speculative monetary-financial flows and only collaterally would stimulate sustainable growth and economic restructuring. The EU single currency could be beneficial for all member states just conditioned by a well-balanced correlation between the nominal and real aspects of the economy.

After the effective failure of the initial versions of the Stability and Growth Pact (including the 'revised' form in 2005), there has been set up the *Macroeconomic Imbalance Procedure* (MIP) for supervising, in a more coherent manner, both nominal and *real* indicators, involving *Alert Mechanism Reports.*[10] This time 11 indicators have been selected, among which private sector debt share (consolidated) in GDP and changes in total financial sector liabilities. The threshold for private debt (non-financial businesses and households) has been set at 133% of GDP (a first tentative limit of 160% had also been considered). As regards the financial sector liabilities, only year-on-year changes are analyzed. However, after about two years of MIP, "there has been little progress so far in reducing excessive private debt, although credit flows have been very low or even negative in many countries…"[11] In fact, euro-area total private debt has been estimated at over 400% (in 2013).

MIP seems to be a step in the right direction, but one should not neglect that macroeconomic stability cannot be a goal in itself: previous experiences (such as the dramatic 1930s) showed that 'macroeconomic equilibrium' may coexist with a strikingly low level of real economic activity which means large quantities of *unemployed* factors of production. Therefore a new social danger is looming: the so-called *jobless growth* (modest GDP growth rates, accompanied by ever higher unemployment levels).[12]

This specific case updates the essential difference between the *productive* investment and the *speculative* investments (such as the famous financial *derivatives).*If the previous ascending phase of the last long cycle seemed to focus on the expected benefits of the globalization, the present descending/stagnant phase mainly reveals the perils of this contradictory process. Consequently the amplifying trend of the total debt has become a world-wide phenomenon. The global indebtedness – comprising both the public and private components – is representing more than 300% of the world GDP (313% at the beginning of 2013): debt in developed states has amounted

[10] Regulation (EU) of the European Parliament and of the Council, entered into force in December 2011.
[11] European Commission, Alert Mechanism Report, Brussels, 13.11.2013, p.1.
[12] According to Real Time Economics (from The Wall Street Journal), 2013 collection.

to almost 160 trillion US dollars (nearly 380% of GDP) and emerging market economies' debt has been over 66 trillion US dollars (more than 220% of GDP).

Endeavouring to alleviate this troublesome situation, *open market operations* (OMO) may be adequate for monetary policy in relation with the government debt and the biggest banks, while the 'discount window' should be revitalized for middle & small banks, more directly linked to the investment process of the SMEs. Both the ever higher total debt (public & private) and immense funds 'injected' by central banks in economy to ease the financial crisis' consequences seem to indicate that the type of macroeconomic interventions, that was relatively successful till the end of the 20-th century, has been approaching its upper limits in the last decade. As H.Minsky concluded at the end of his main work, the fundamental destabilizing nature of capitalist finance would make necessary a *periodic and profound restructuring and reforming of the institutional framework of the economy.*

In the aftermath of the international financial & economic crisis, the Minskyan vision and critical analysis of capitalism is still seminal for restructuring society[13]: monopolies and oligopolies ever more representing a special form of 'tax collectors' (as new kinds of rent that have been mentioned before), public control or even public property of large capital intensive production units remains essential for solving vital social problems. The role of the public sector should not be confined to fiscal policies (taxes & expenditures), but it should also involve investment resources in economic activities generating value-added activities, which could finally be self-financing. As the 'socialization' of the costs of the crises is already a '*fait accompli'*, while the profits remain private, it would be quite fair to 'socialize' at least part of the benefits obtained in both the public and private sectors (social solidarity).

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[13] See chapters 12 &13 of "Stabilizing an unstable economy" (New Haven: Yale University Press, 1986 or McGraw Hill Professional, 2008).