# It's the private debt, stupid!

By T Sabri Öncü

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Originally coined by his campaign strategist James Carville as "the economy, stupid!" for the internal consumption of Bill Clinton's election campaign team, "it's the economy, stupid!" was Bill Clinton's slogan in his successful presidential campaign against George H W Bush in 1992. Had Bill Clinton been able to run against Donald Trump in the 2016 United States (US) presidential election and the International Monetary Fund (IMF) been his campaign strategist, his 2016 election campaign slogan could have been "it's the private debt, stupid!"

## Notable Warnings

In its October 2016 *Fiscal Monitor* titled "Debt—Use It Wisely" (IMF 2016), the IMF issued a stark warning to the world that the sheer size of the non-financial sector debt—comprising the general government, non-financial firms and households—could set the stage for an unprecedented private deleveraging process that could thwart the fragile economic recovery of the world, indicating the difficulty of resolving the "private debt overhang" problem in the current global environment of low nominal output growth.

At $152 trillion or 225% of the world gross domestic product, the global debt of the non-financial sector has reached an all-time high in 2015 and two-thirds of this debt, amounting to about $100 trillion, consists of liabilities of the private sector, as the IMF indicated. As I mentioned in my July 2016 EPW article (Öncü 2016), since the Deng–Volcker–Thatcher–Reagan Revolution of 1978–80, the economies polarised between creditors and debtors, the debt burden shifted from the public sector to the private sector through austerity programmes and much of this accumulated private sector debt in almost everywhere around the globe is currently unpayable. In October 2016, the IMF was simply restating what I stated already in July 2016, and neither the IMF nor I was the only one who made such statements in 2016, not to mention many others who made similar statements in earlier years.

The first notable warning of 2016 came from the former Bank of International Settlements Chief Economist William White. As noted in an article in the *Telegraph* by Ambrose Evans-Pritchard (2016a), below are a few excerpts from White's statements.

> The situation is worse than it was in 2007. Our macroeconomic ammunition to fight downturns is essentially all used up ... Debts have continued to build up over the last eight years and they have reached such levels in every part of the world that they have become a potent cause for mischief ... The only question is whether we are able to look reality in the eye and face what is coming in an orderly fashion, or whether it will be disorderly. Debt jubilees have been going on for 5,000 years, as far back as the Sumerians.

Indeed, this was precisely one of the topics for debate I suggested to the Indian reformers on the occasion of the 25th anniversary of their financial and economic reforms in my July 2016 article:

"Writing down debts in keeping with the ability to pay."

## Enters Bill Gross

In an interview with Bloomberg on 26 May 2016, a co-founder and former Chief Investment Officer of Pacific Investment Management Company (PIMCO), and current portfolio manager at Janus and billionaire bond investor Bill Gross joined the choir and said the following.

> I'm not endorsing that. I think at some point, Japan will basically buy up all its debt and the central bank

> will forgive the treasury and try to move forward with that. I see no other way out for Japan. (Gittlesohn 2016)

It is my speculation that Bill Gross heard that 26 of May is my birthday and wanted to give me a birthday gift by issuing the above statement. His birthday gift was much bigger since he also said this:

> Ultimately, they could own all the market. At that point they could say to the fiscal side, 'Olly olly oxen free. You don't have to pay us back. Or we'll extend your debt to 50 years with a zero percent coupon and at that point we'll essentially eliminate the entire obligation.'

Finally, he said:

> I have a sense that that's the route central banks will pursue. They'll keep on buying debt, keep interest rates low and then ultimately the treasury doesn't owe them anything.

What better birthday gift could I have asked of him?

## Enters the UNCTAD

Another notable warning of the year came from the United Nations Conference on Trade and Development (UNCTAD). In September 2016, the UNCTAD published their *Trade and Development Report* (TDR) titled "Structural Transformation for Inclusive and Sustained Growth" (UNCTAD 2016). One of the most striking statements of this year's UNCTAD TDR was that alarm bells have been ringing over the explosion of corporate debt levels in emerging economies, which now exceed $25 trillion. Damaging deflationary spirals cannot be ruled out.

A few days after publication of the UNCTAD TDR, Evans-Pritchard (2016b) jumped on the bandwagon again with an article titled "UN Fears Third Leg of the Global Financial Crisis—with Prospect of Epic Debt Defaults." He wrote: "If trade economists at the United Nations are right, the next traumatic episode may entail the greatest debt jubilee in history."

As also noted by Evans-Pritchard (2016b), below are some excerpts from the UNCTAD TDR.

> If the global economy were to slow down more sharply, a significant share of developing-country debt incurred since 2008 … could become unpayable and exert considerable pressure on the financial system (p IV–V) ... There remains a risk of deflationary spirals in which capital flight, currency devaluations and collapsing asset prices would stymie growth and shrink government revenues … As capital begins to flow out, there is now a real danger of entering a third phase of the financial crisis which began in the US housing market in late 2007 before spreading to the European bond market (p III).

## What Is Jubilee?

In Part J of his yet-to-be-finished dictionary titled "The Insiders Economic Dictionary," the economist Michael Hudson (2013) wrote the following.

> Jubilee Year: In Judaic Law (Leviticus 25) a Clean Slate to be proclaimed every 50 years annulling personal and agrarian debts, liberating bond-servants to rejoin their families, and returning lands that had been alienated under economic duress. Long thought to have been merely a literary religious ideal, the policy has now been traced back to royal proclamations issued as a matter of course in Sumer and Babylonia in the third and second millennia BC.

One minor correction to Hudson's dictionary is that the Jubilee year used to come every 49 years (seven Sabbath years—Sabbath means to cease, to end or to rest) rather than 50 years. The Jubilee is not a religious fiction or ideal as some think it is. It used to happen quite often and debt write-offs happen quite regularly even these days.

What do Indians think their Corporate Debt Restructuring (CDR) Cell has been doing since 2001? Those Indians who do not know what the CDR Cell is should ask their central bank, the Reserve Bank of India (RBI). The CDR Cell is an office in south Mumbai. It is the office that facilitates the CDR Mechanism. The RBI introduced the CDR Mechanism on 23 August 2001 for implementation by financial institutions and banks with the intention of reviving those corporations that "find themselves in financial difficulties because of factors beyond their control and also due to certain internal reason."[1] Another important recent example is Germany's miraculous economic takeoff after World War II, which was triggered by the 1947 allied monetary reform and debt cancellation—a form of Jubilee.

To cut a long story short, "financial difficulties because of factors beyond control" have been happening since the Neolithic Revolution—sometimes called the Agricultural Revolution—when a transition of human cultures from hunting and gathering to agriculture and settlement occurred about 12,500 years ago. Put differently, unlike many believe, economic depressions and financial crises are not a product of capitalism. They have been with human societies since the Neolithic Revolution with which agricultural production started. And debt restructurings and write-offs have been going on since then. Even Ayat 275 of Baqarah Surah of the holy book of Islam, Quran, is about debt restructuring, although what is being ordered is not to reduce or cancel the remaining principal but to forgive the remaining interest.

## Debt Deflation Theory

"Debt Deflation Theory of Great Depressions" is the title of an article the well-known economist Irving Fisher published in the famous journal *Econometrica* in 1933.[2] Although he wrote in this article that his then opinion was purely tentative, he claimed the following.

> (1) Debt liquidation leads to distress setting and to (2) Contraction of deposit currency, as bank loans are paid off, and to a slowing down of velocity of circulation. This contraction of deposits and of their velocity, precipitated by distress selling, causes (3) A fall in the level of prices, in other words, a swelling of the dollar. Assuming, as above stated, that this fall of prices is not interfered with by reflation or otherwise, there must be (4) A still greater fall in the net worths of business, precipitating bankruptcies and (5) A like fall in profits, which in a 'capitalistic,' that is, a private-profit society, leads the concerns which are running at a loss to make (6) A reduction in output, in trade and in employment of labor. These losses, bankruptcies, and unemployment, lead to (7) Pessimism and loss of confidence, which in turn lead to (8) Hoarding and slowing down still more the velocity of circulation. The above eight changes cause (9) Complicated disturbances in the rates of interest, in particular, a fall in the nominal, or money, rates and a rise in the real, or commodity, rates of interest.

The above is more or less what has been happening since the summer of 2007, when the ongoing global financial crisis started, if not since April 2000, when the US technology index NASDAQ tanked and the ongoing Greatest Depression of the entire human history since the Neolithic Revolution started.

## What Is To Be Done Now?

Before I make a suggestion, let me mention one more issue. It is the household debt to disposable income ratio. This ratio is about how much of your income you use to pay your debt. The higher is the ratio, the less you can spend to buy things. Do not Keynesians call this lack of aggregate demand, if this ratio is too high?

A global household debt to disposable income ratio cannot be known because of the difficulties in collecting relevant global data, especially in the existence of a huge informal economy in many parts of the globe, but this ratio has reached unheard of proportions since the Deng–Volcker–Thatcher–Reagan Revolution of 1978–80. In most parts of the world, this ratio is above 50% and it can go as high as 300% in other places, according to data from the OECD.[3]

Now, my suggestion, as I am unable to see any other way out of this mess.

A global Jubilee is in order.

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## Notes

1 See CDR's "About Us" (http://www.cdrindia.org/aboutus.htm).

2 Irvine Fisher's paper can be viewed at https://fraser.stlouisfed.org/docs/meltzer/fisdeb33.pdf.

3 See the following web link for the data, https://data.oecd.org/hha/household-debt.htm.

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