Death by Debt

William Leiss (31 October 2011)

Here are extracts from Chapter 3 of my book, *The Doom Loop in the Financial Sector, and Other Black Holes of Risk* (University of Ottawa Press, 2010), pp. 101-2:

> Thus, by the middle of 2010 six of the seven largest economies in the world looked to be in no shape ... to spend their way out of another serious financial meltdown for a very long time to come [due to accumulated debt levels].... Recent events have seriously eroded the margin of safety in the discretionary public resources available to most of the world's wealthiest economies; that is, the capacity of their governments to incur additional debt responding to a further financial crisis,..."

Here is the abstract for the paper, "The real effects of debt," by Stephen G. Cecchetti, M. S. Mohanty, and Fabrizio Zampolli, Working Paper No 352 (Bank for International Settlements, Geneva), September 2011: http://www.bis.org/publ/work352.htm.*

> At moderate levels, debt improves welfare and enhances growth. But high levels can be damaging. When does debt go from good to bad? We address this question using a new dataset that includes the level of government, non-financial corporate and household debt in 18 OECD countries from 1980 to 2010. Our results support the view that, beyond a certain level, debt is a drag on growth. For government debt, the threshold is around 85% of GDP.... Our examination of other types of debt yields similar conclusions. When corporate debt goes beyond 90% of GDP, it becomes a drag on growth. And for household debt, we report a threshold around 85% of GDP, although the impact is very imprecisely estimated.

Most OECD countries or regions are already at or beyond these debt levels, and they are still steadily rising. The upshot is the risk of a spreading of the decades long "Japan stagnation" economic model to other major economies.

And yet, thanks to fierce lobbying and generous financial contributions to politicians, global financial institutions, and particularly those in the U.S., have been able to beat back the most basic and meaningful reforms that would be likely to prevent another serious financial crisis. As Thomas Friedman wrote in yesterday's *New York Times:* "Capitalism and free markets are *the* best engines for generating growth and relieving poverty — provided they are balanced with meaningful transparency, regulation and oversight. We lost that balance in the last decade. If we don't get it back — and there is now a tidal wave of money resisting that — we *will* have another crisis." And the next time there will be nothing left in the public treasuries to kick-start the recovery.

*See Brian Milner & Tim Kiladze, "A solution based on hope encounters grim realities," *The Globe and Mail,* Report on Business, 29 October 2011, B7: http://bit.ly/uVWBOK