

Debt – Economic, Political and Moral Consequences

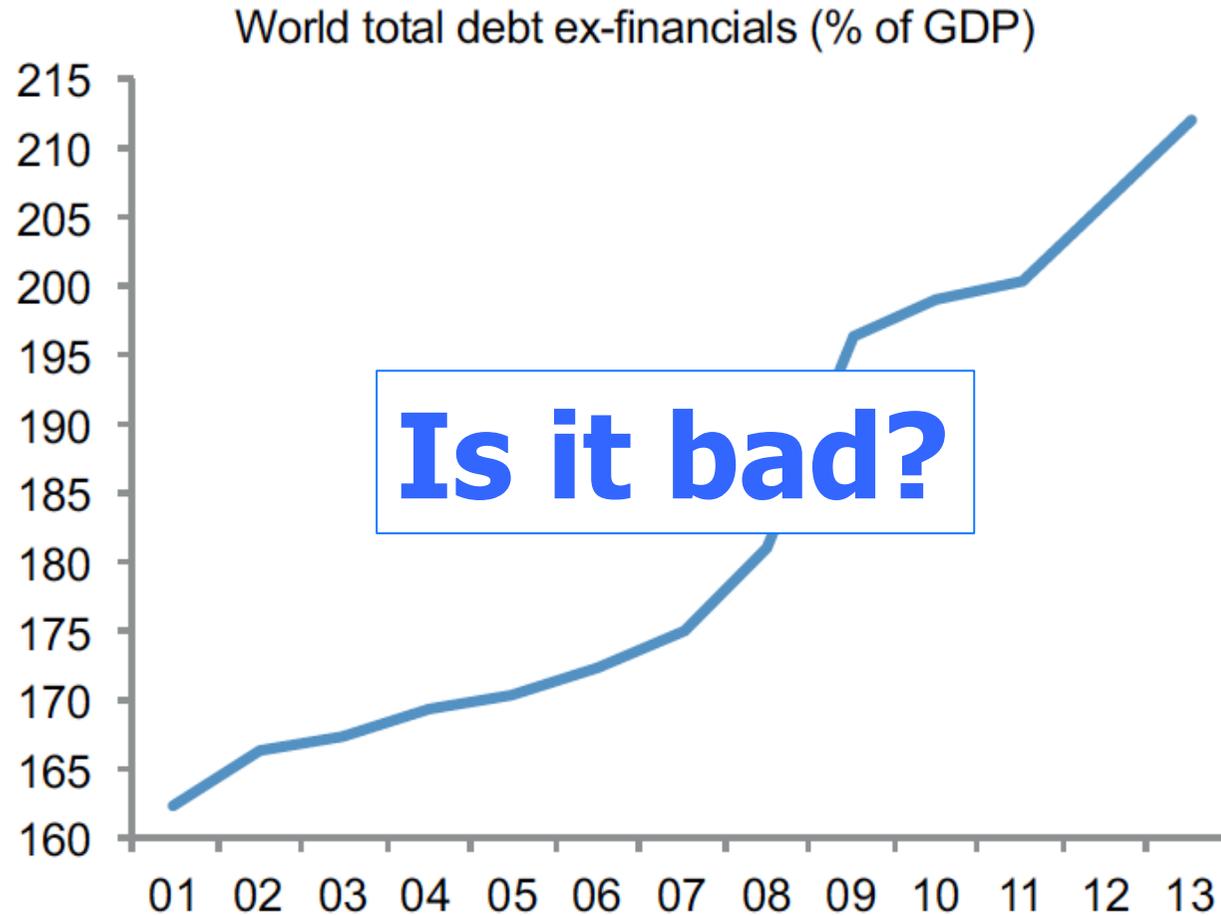
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Debts: the current issue

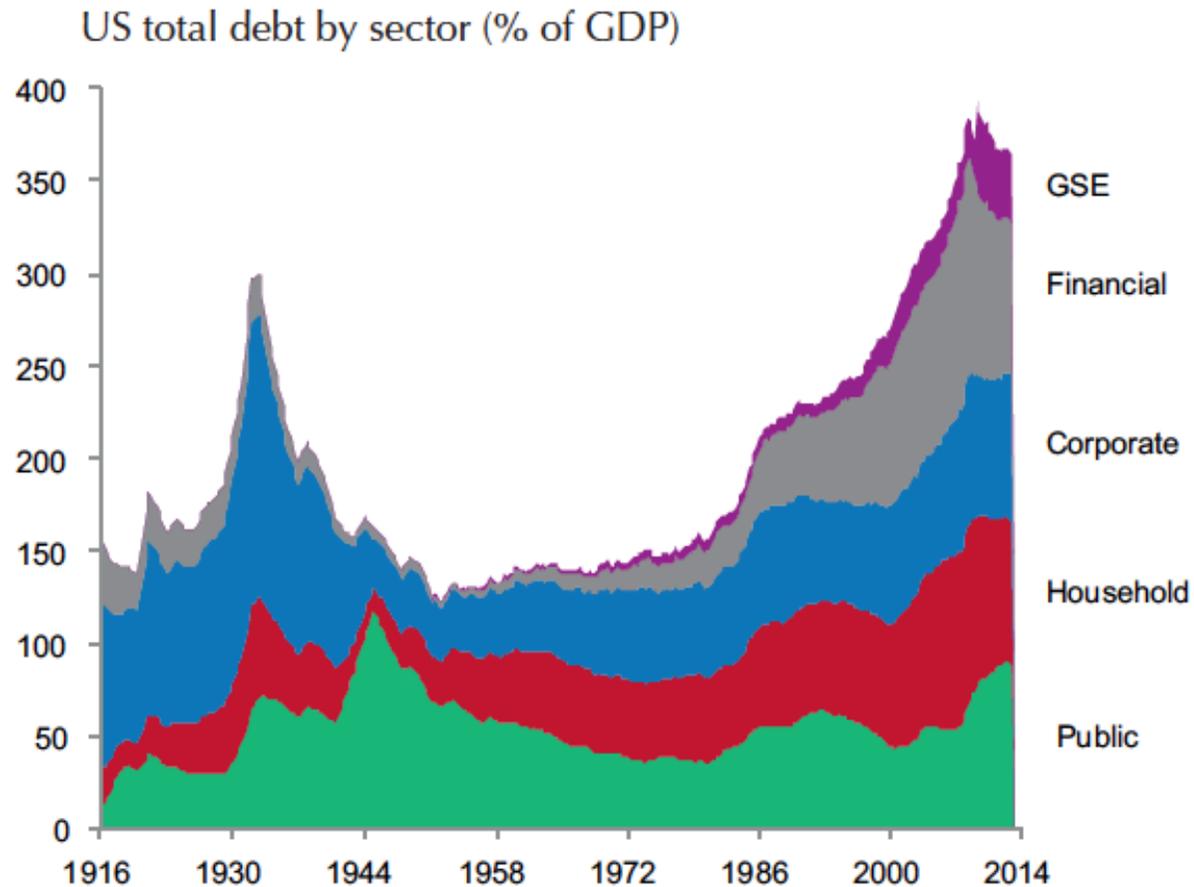


Source: *Geneva Report 16*

The economics: why debt may be bad

- High indebtedness leads to deleveraging
- Debtors may be unable/unwilling to pay back
- Bad allocation
 - Bonds vs. stocks
 - Private vs. public
- Fragility
 - Interest rate increases
 - Cyclical downturns

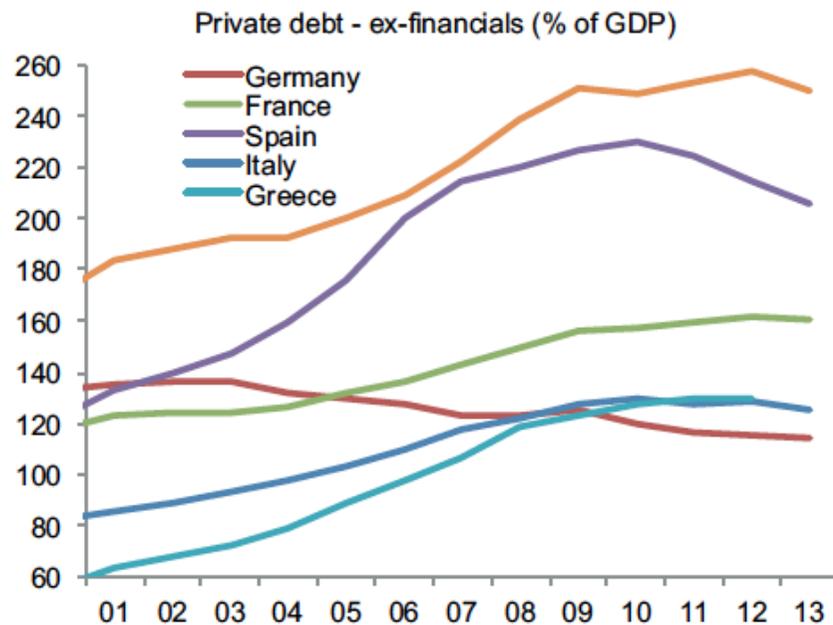
The economics: why debt may be bad



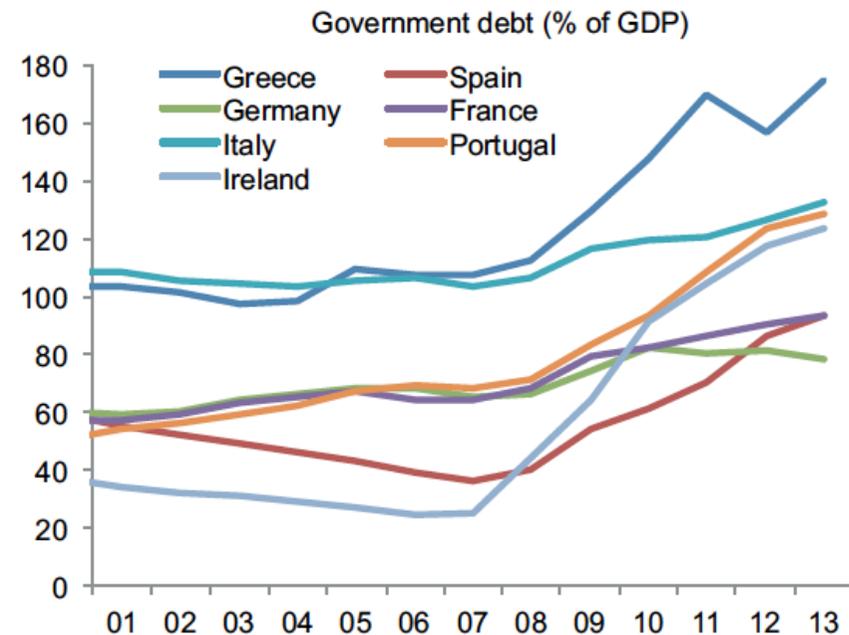
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The economics: why debt may be bad

Selected Eurozone countries' private debt



Eurozone countries' public debt



Source: *Geneva Report 16*

The economics: EC101 analysis

- A debt is a loan
 - Too much borrowing or too much saving?
- The secular stagnation story
 - Real rates decline since late 1980s
 - But...
 - Return to previous levels?
 - China and other emerging markets
 - Demographics
- Anyway: savers need borrowers, and vice versa
 - The issue is financial market fragility

Debts and morality

- Moral hazard: a dangerous terminology for a deep concept
 - It is about incentives
 - Nothing particularly moral
 - Borrowers make a commitment
 - Savers take a risk
- } No innocent bystander
- When words make up for analysis
 - A debt is not a sin, it is a financial instrument
 - For moral hazard, we need that when no repayment:
marginal cost \geq marginal return

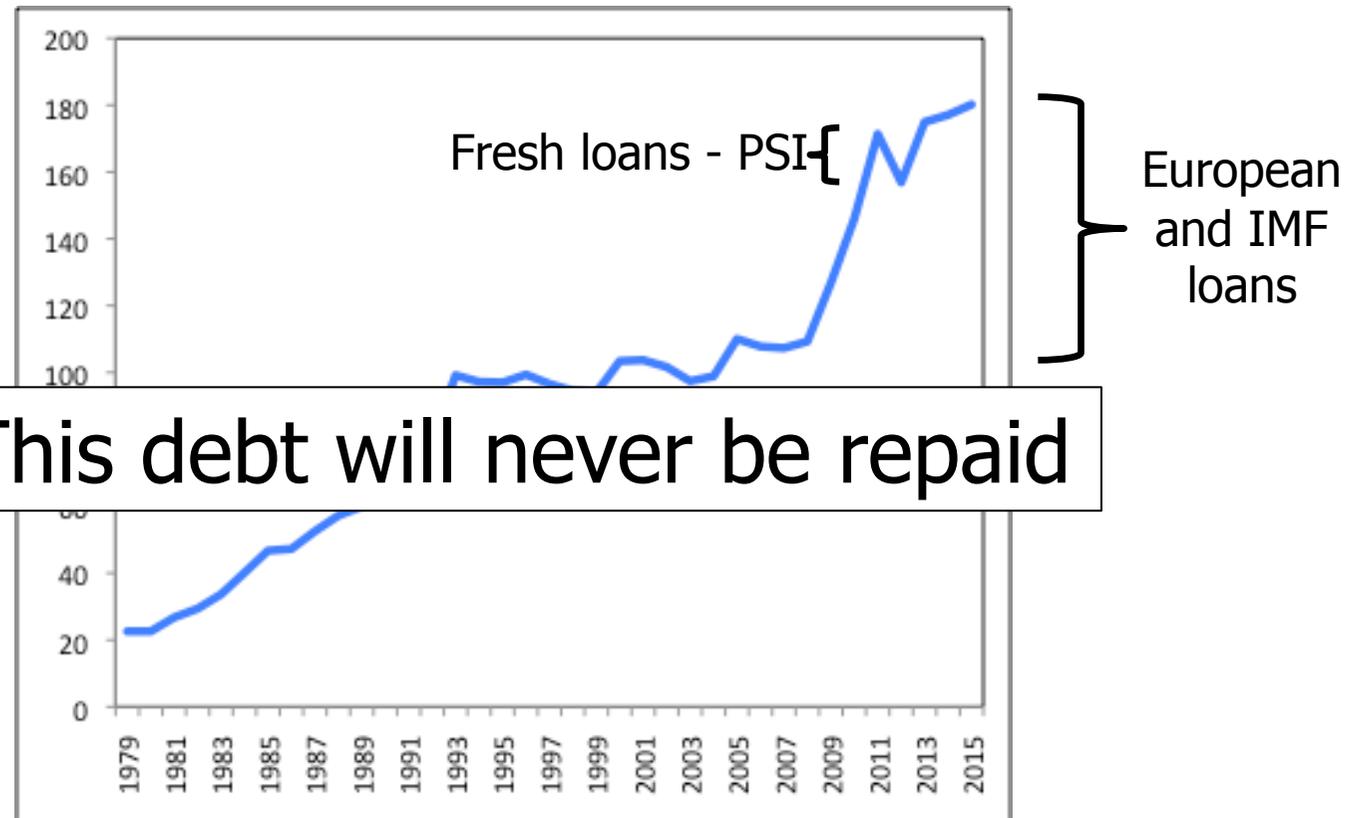
Debts and political consequences

- Excessive debt service can have drastic effects
 - Private debtors

“The rich rule over the poor, and the borrower is a slave to the lender.”
Proverbs 22.7
 - Sovereign debtors
 - Harsh conditions lead to political turmoil
 - The IMF as universal bad cop
- Non repayment hurts borrowers and lenders
 - Borrowers lose market access
 - Lenders suffer losses

A burning example: Greece

Government debt (% of GDP)



Source: IMF Historical Statistics

A burning example: Greece

- If the debt will be written down
 - Why keep lending?
 - Why keep borrowing under difficult conditions?
- What about the moral aspects?

“There is no economic ground for Germany to be the only European country in modern times to be granted large scale debt restructuring and debt relief, and certainly no moral ground either. The supposed ability of today’s most heavily indebted European countries to reduce their obligations over time, by such measures as shrinking their expenditures and restructuring their economies, is yet another fiction—and in this case not a useful one.”

Benjamin Friedman, “The Pathology of Europe’s Debt”, *New York Review of Books*, 2014.

Is debt forgiveness heavenly?

²³ “Therefore the kingdom of heaven may be compared to a king who wished to settle accounts with his servants.²⁴ When he began to settle, one was brought to him who owed him ten thousand talents.²⁵ And since he could not pay, his master ordered him to be sold, with his wife and children and all that he had, and payment to be made.²⁶ So the servant fell on his knees, imploring him, ‘Have patience with me, and I will pay you everything.’²⁷ And out of pity for him, the master of that servant released him and forgave him the debt.²⁸ But when that same servant went out, he found one of his fellow servants who owed him a hundred denarii, and seizing him, he began to choke him, saying, ‘Pay what you owe.’²⁹ So his fellow servant fell down and pleaded with him, ‘Have patience with me, and I will pay you.’³⁰ He refused and went and put him in prison until he should pay the debt.³¹ When his fellow servants saw what had taken place, they were greatly distressed, and they went and reported to their master all that had taken place.³² Then his master summoned him and said to him, ‘You wicked servant! I forgave you all that debt because you pleaded with me.³³ And should not you have had mercy on your fellow servant, as I had mercy on you?’³⁴ And in anger his master delivered him to the jailers, until he should pay all his debt.³⁵ So also my heavenly Father will do to every one of you, if you do not forgive your brother from your heart.”

Matthew 18:23–35