Sep 9th, 2012, Alexandra Park.

Themes: Notes on Debt

From whence it comes, to where it goes

A debtor is an entity that owes a debt to another entity. The entity may be an individual, a firm, a government, etc. The counterparty is called a creditor.

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Debts are related to the functions of money, which are:

1. A medium of exchange.
2. A store of wealth.
3. A measure of debts.

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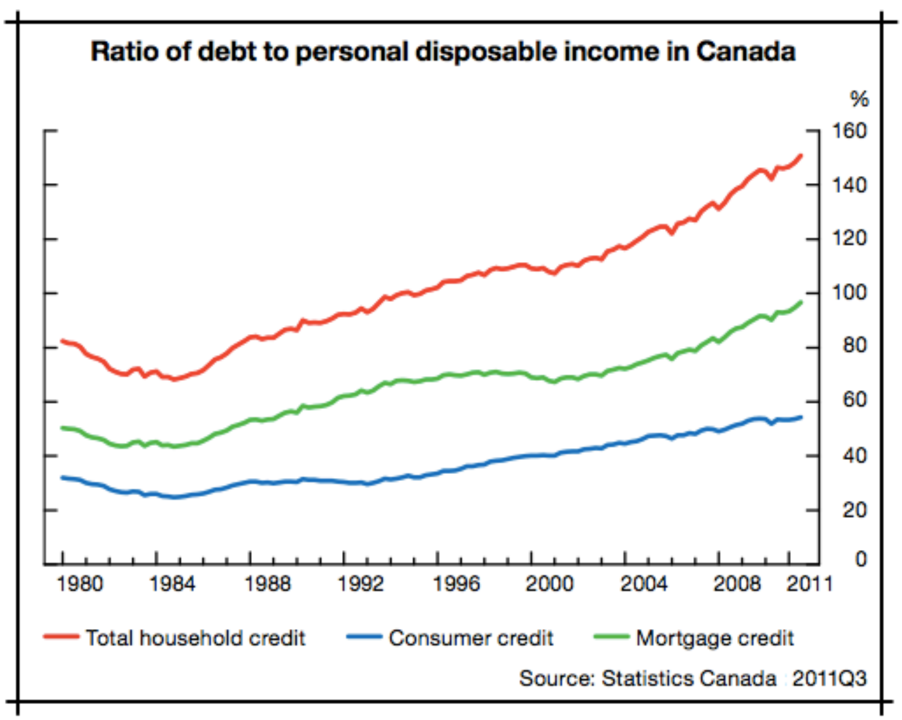
Household debts include bank loans, lines of credits, mortgages, credit card debt, car loans, student loans, store credit, etc.

Some types of debt can be pooled by financial institutions and reissued as securities, sold directly to wealth owners, or to investment funds (in particular, hedge and equity funds) that pools wealth money.

Mid 2012: average private debt per Canadian $112,329

Private debt to income ratio: +150%.



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The demand for debt comes from owners of wealth, who wants to convert wealth that is in money form (as all new additions to wealth almost invariably start out as being), which doesn't earn income but conversely will fall in effective value (purchasing power) with inflation, into investments that earn a profit and thereby assure that wealth creates more wealth.

Wealth owners can choose between investing in the economy's production assets (ownership stakes such as stocks), or invest in interest yielding debt.

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Debts of firms essentially transfer profits between owners of production assets (real sector capitalists) and owners of money (financial sector capitalist), in other words they transfer incomes between different groups within the 1%. We can therefore ignore this aspect if the purpose is to study how debt transfers income between different classes.

Note: The real sector produces and distributes goods and services. The financial sector deals with money, debt and insurance (risk hedges).

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Since the 1% owns wealth, they are assumed to have no net private debt.

Thus, society's net debt is owed by governments, and lower and middle incomes households.

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Government, or public debt are, in turn, owed by us all, in a relation to our tax liability.

Public debt, 2011	bn $1,315
Public debt per person:	$38,404
Public debt to GDP ratio:	82%.

The direct cost of public debt is about 10 cents of each government revenue dollar (Drummond report).

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Ignoring cross-border, or international, debt relations, the 1% are the ultimate owners of all debts. However, in order to create a true net figure, their share of liability for the public debt must be netted out.

This relation is generally overlooked in tax cut debates. First of all, tax cuts—no matter almost how they are designed—will always benefit high incomes the most.

But tax cuts not only give the 1% more disposable income, they also reduce their liability for the public debt.

A crucial relation is that public debts in the first place mainly exist because the 1% don't pay their fair share to the upkeep of society.

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Another important relation in the neoliberal economy—the economy that emerged after post-war 'soft capitalism' with traits of welfare economics was abandoned around 1980—is that it incurred a sharp rise in distributive inequalities.

The 1%'s share of national pretax income in United States

This rise is partly a consequence of the intensification of monopolistic competition, incurred by market concentrations and rising dominance of large, multinational corporations that have been able to diversify production to low-cost destinations, in the process boosting aggregate profit levels substantially.

The rise in income inequalities meant that the demand for wealth objects, objects that can store wealth, has risen correspondingly.

However, when the growth in wealth is faster than the rise of the real economy (and real economy growth rates have been falling in a trend converse to wealth growth) the concomitant strong demand for objects that can store wealth will show a tendency to lead to asset inflationary bubbles, with recessions to follow when they burst and freeze credit, including credit to the real economy (the dot-com and housing market bubble in the U.S. are examples of such cycles).

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The private sector's net debt is caused by a mismatch between consumption expenditures and incomes, including the expenditures that are related to the 'consumption' of a living space, i.e. owning a house. It should be noted that a mortgage debt is only net debt to the extent it is bigger than the equity built up in the house.

Since service of private sector debts transfer incomes from lower and middle class households to the 1%, it is an important factor in determining income distributions and social conditions.

High level of government debts impacts society by constraining governments' ability to develop infrastructures, including social infrastructures such as education and health care. It will also constrain abilities to engage in poverty reducing programs and income support measures for low incomes families.

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Household debt can roughly be divided into two categories: voluntary debts and forced debts.

Voluntary debts are typically middle class debts that are raised because of the neoliberal cultures constant urge to engage in status consumption, but under conditions where incomes, due the rising share of incomes that goes to the 1%, have been stagnant.

Forced debts are typically raised by lower incomes groups who juggle dwindling incomes by maxing out credit cards, taking out payday loans, etc. Sometimes forced debt are raised by former middle class households who has lost jobs or other sources of incomes and thus has fallen out of the middle class, but desperately attempts to hang on to their middle class consumption patterns by maxing out all forms of access to credit, including credit cards, house equity, etc.

In particular in the U.S., costs of health care are often a cause of forced debts.

Forced debts must also be considered including student loans and other costs of higher education.

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A consequence of debt relations is to constrain liberty. It combines with other poverty and economic inequality relations to force people to make choices that reduce their access to creative and self-actualizing life styles.

For instance, students who only can complete higher education by assuming high student loan debts will feel forced to make career choices that quickly give them access to stable incomes, rather than follow their aspirations.

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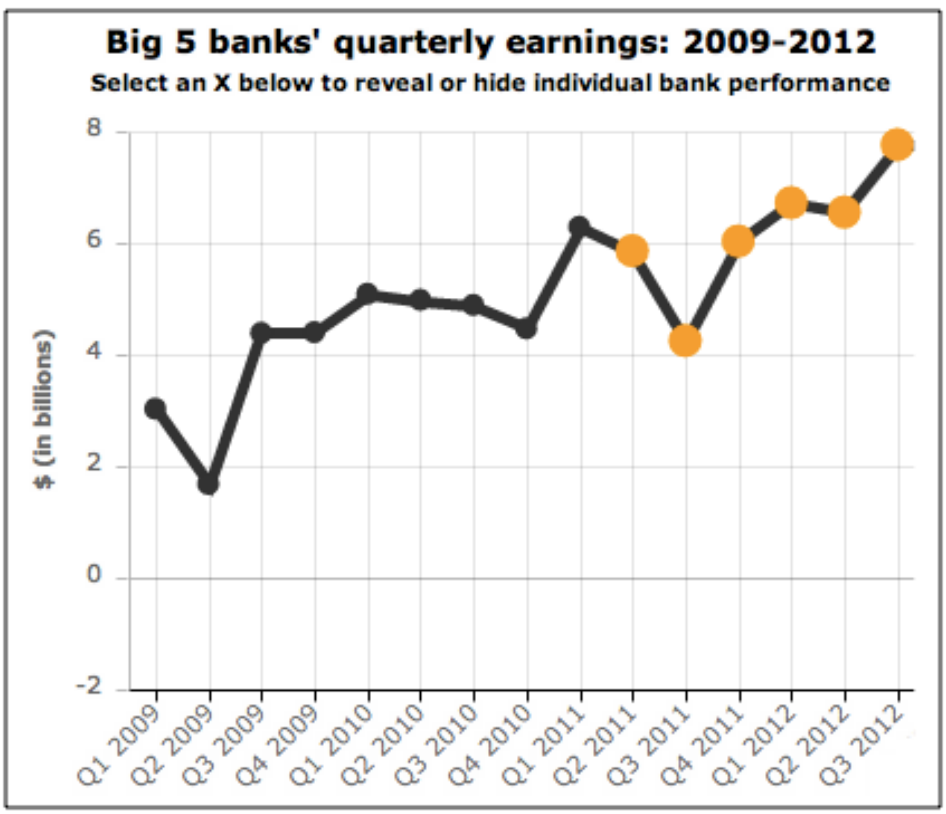
Canadian banks have a central position in the debt economy, and are major links in the economic chains that concentrate wealth among the 1%.

Third quarter 2012, the big 5 banks' earnings was $7.8 billion, and fiscal year to date (bank fiscal year starts in November) more that $20 billion:



The figure is taken from this article:

CBC News, Aug 30, 2012: Big banks dish out dividend gold rush as profits soar. http://www.cbc.ca/news/business/story/2012/08/30/banks-profits-dividends.html