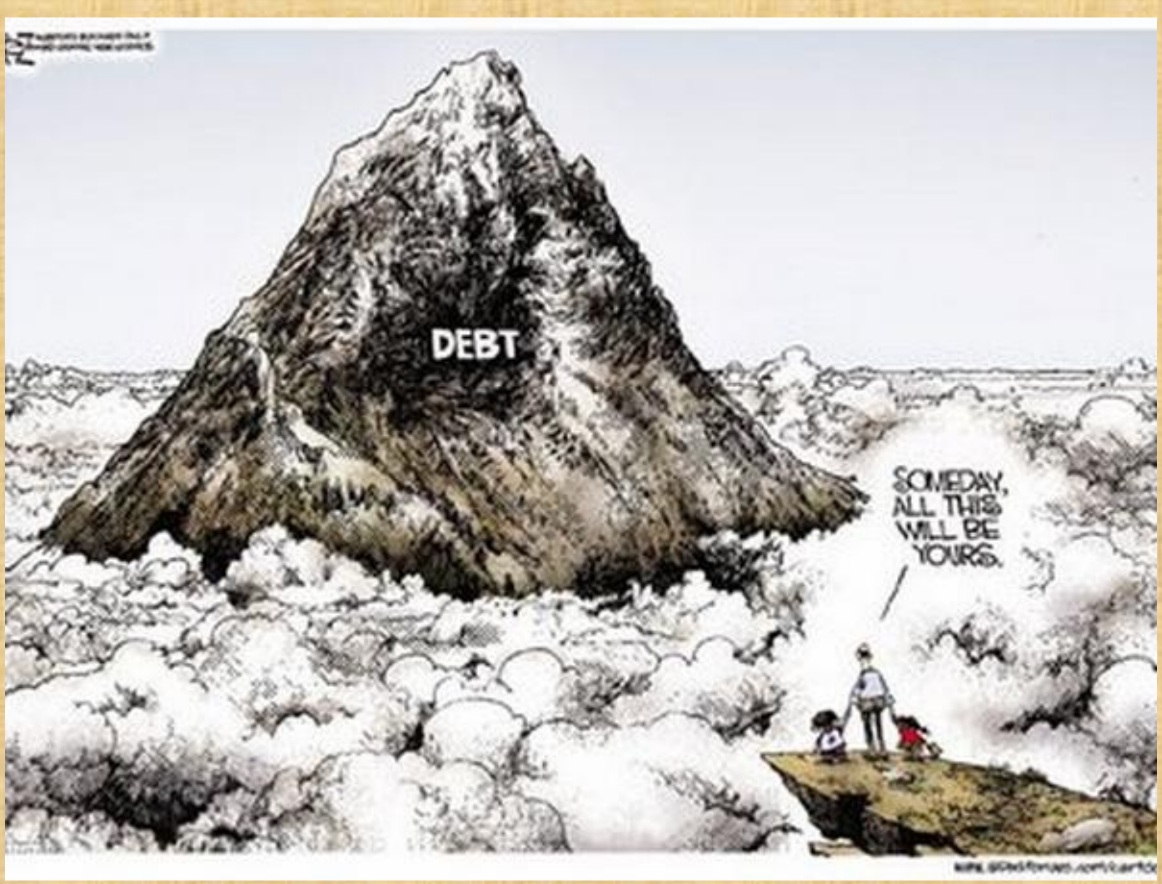

THE POLITICAL ECONOMY OF (PUBLIC and private) DEBT

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Some Basic Institutions of Modern Capitalism

States and Markets

Money and Credit – the Banking System

Market Monopoly, Tax Monopoly and the Money Monopoly of the modern State

Financial Markets - Bonds and Shares and the Transformation of Banks

The invention of the permanent debt

Public credit, public debt and credit money

Public Debt and Central Banks

CLASSICAL DEBATES – Monetarism to Neomonetarism / Chartalism to Neochartalism

- Money Does not Matter at all
- Capitalism as a Barter Economy
- Money as a Commodity
- Metallic Circulation

- Money Does Matter a lot
- Capitalism as a Credit Economy
- Money as a Token / Symbol
- Credit Circulation

Classical Debates

- Money and Capital – conceptually, empirically (f.i. M1 – M3 and beyond)
- Exchange and Circulation (or the elusive concept of the “Market”)
- Circulation and the Reproduction process of the Economy and Society
- Circulation and growth/development: Monetary and credit cycles, (longer and shorter) waves of reproduction and innovation

FINANCIAL REFORMS and REVOLUTIONS

- THE INVENTION OF COINAGE
- THE INVENTION OF BANKING AND PRIVATE MONEY (BILLS OF EXCHANGE – BANKERS' NOTES)
- THE INVENTION OF PAPER MONEY
- THE INVENTION OF THE PERMANENT DEBT
- THE INVENTION OF THE CENTRAL BANK (NOTE ISSUE MONOPOLY)
- THE INVENTION OF THE CENTRAL BANK OF THE CENTRAL BANKS (the BIS)

FREE NATIONs – DEEP IN DEBT

- Shift of Liabilities - from the King to the Government to Parliament (eventually ‘the State’ and all its citizens)
- Creation of the State Budget (unified, compre-hensive, specified) – and its corollaries (Budget law, public Budget control)
- The public debt – the common property of modern nations (a result of the nationalisation and centralization of public credit / public debt)
- Link(s) between representative, parliamentary democracies and the public debt

The permanent Public Debt

Instead of sinking funds – consolidation and conversion (refinancing) public debt permanently

Establishing a permanent structure of primary (bond issuing) market and secondary (trading) market for sovereign debt

Importance of interest rates – and the impact of sovereign debt

The State as the borrower of last resort

Central bank as the lender of last resort

The permanent credit / debt economy

- Turning money into a commodity again (with two prices: interest and exchange rates)
- Turning credit into commodities (the transformation of credit devices / tokens into tradeables)
- Financial markets: The world of fictitious commodities, fictitious money and fictitious capital
- Differentiation and hierarchisation of financial markets (money markets, capital markets, commodity markets, markets for firms, derivative markets)
- Capitalist development: Credit for all! (A secular change: the integration of all economic actors into the credit system – due to the rise of the welfare state)
- However: the social distinction / discrimination in terms of ‘creditworthyness’ does not disappear at all – the different (under)worlds of credit persist

The Changing Hierarchies of Money and Credit

- Forms and functions of money – not all forms of money can fulfill all and every function of money
- The basic function of a ‘measure of value’ cannot be fulfilled by fiat / credit money [big issue in monetary theory since the end of BW]
- Why do the good coins disappear from circulation? (an excellent means of hoarding)
- The function of means of circulation can be fulfilled by various forms of money (but not universally, free circulation only within particular groups)
- The functions of means of payment can be fulfilled by various forms of money
- One form of private money can be substituted by another (not without limits, as long as the monetary authority of the state does not interfere)
- Private money turned into public money – the qualification as ‘legal tender’ is crucial
- Financial assets as ‘money’ (means of payment in very restricted areas), risky as a means of hoarding

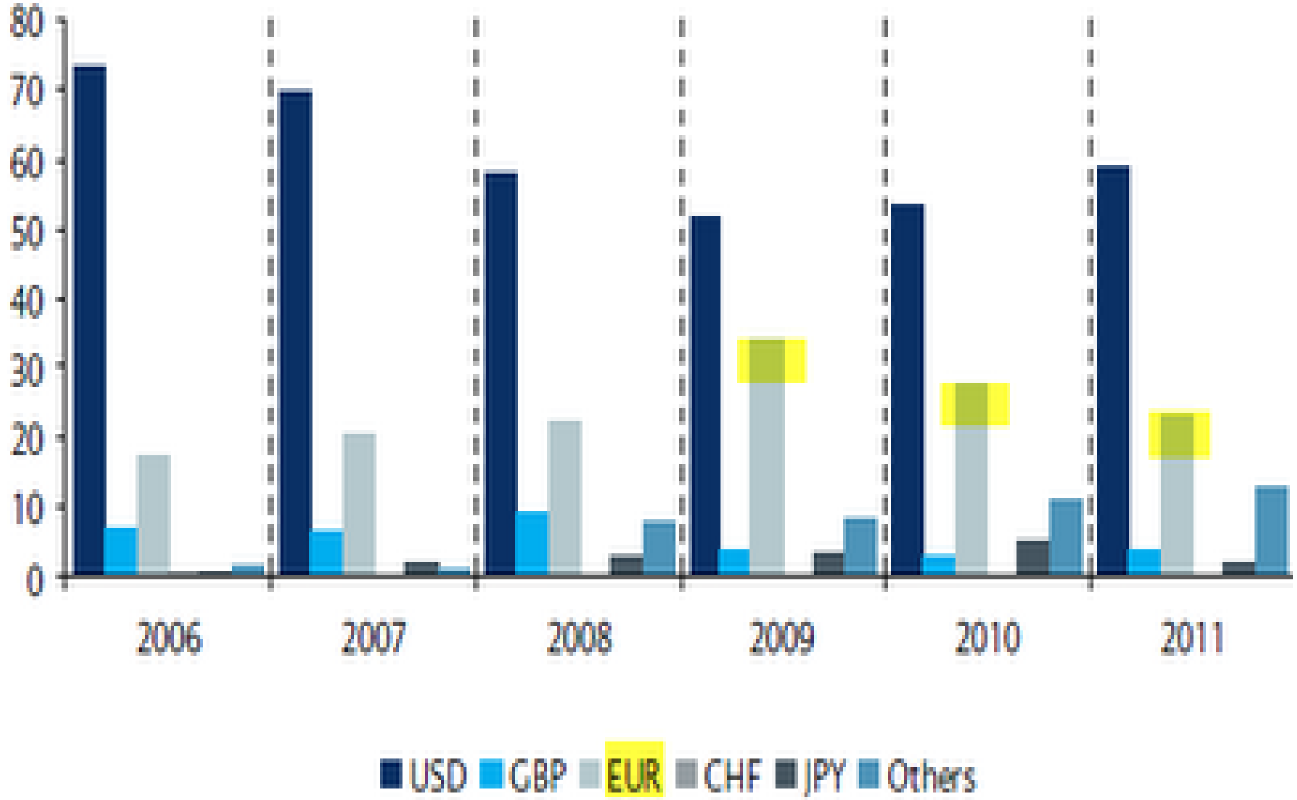
Monetization of the public debt

- Public debts, private banks and the propertied classes
- Bank reserves – the importance of long term assets
- Central Bank Reserves: The core of the Banking and Credit System
- Increasing proportion of sovereign debt (goverment bonds / gilts) in the reserves of all central banks
- Public credit / sovereign debt as the ‘real’ base of (central) bank notes in circulation

Monetization of public debt in the international circulation

- Foreign currency reserves (US-Dollar and its rivals)
- Foreign sovereign debt reserves (US-Treasury Bonds) [Chinese Central Bank as main example]
- International Gold Standard (a £ Standard, based upon UK government bonds plus gold reserves)
- Bretton Woods Regime (a $ Standard, based upon US Treasury Bonds plus gold reserves)
- After Bretton Woods - an international Standard of rivalling currencies ($ still prevailing), based upon the public credit of some states (USA, Eurozone, Japan, UK)
- Gold, gilts and shares as rival international means of hoarding (and emergency cash/crisis money)

Actual distribution of central bank reserves among major reserve currencies (largely in gov. bonds)



Creditors and Debtors

- Age old relationship – the eternal ‘class struggle’ between creditors and debtors
- In modern economies: The kind of struggle depends on the kind of credit relationship (not all credits are equal in economic terms)
- A nation’s creditors might become a nation’s rulers (James Steuart)
- Why do creditors prevail? Why don’t governments and private debtors not go bankrupt (actually they do)

Distribution and production effects of (public and other) debts

- Debt relations underlying ‘unfree’ labour relations (debt bondage, indented servants, peonage etc)
- Exploitation by means of debt – without any form of labour relationship (from the pawn shop to the mortgage bank)
- Tax exploitation (very tricky)
- Rentiers – the classical image of unearned wealth increasing
- Banks and institutional investors (insurance companies, pension funds) – unequal redistribution of profits, interests and fictitious capital

Financialisation

- Changing relations between creditors, debtors and intermediaries – a revolution that frees finance from the fetters of old fashioned credit (interest) exploitation
- Financial innovations, not by chance discovery, but systematically pursued
- monetary innovations (consumer credit, mortgage finance)
- financial asset innovations – turning every debt into a tradable commodity
- credit innovations (borrowing against long term financial assets, using every asset as a base for new credit)
- financial derivatives – securitization (rendering all assets liquid and fungible, tradable on secondary markets)
- Increasing levels of ‘leverage’ (‘gearing’ in UK financial parlance) – permanent indebtedness of all corporations using debt as a means of financial ‘investment’ (making profits from ‘asset inflation’)

Misunderstanding Banks

- The changing role of Banks – withering away of the old fashioned credit ‘intermediaries’ or ‘money traders’
- The new banks – financial engineers / financial entrepreneurs (professional speculators and dealers in all sorts of ‘financial assets’)
- Creating specialized firms for financial investment – a new breed of investment/ mutual funds (SPVs, Hedge Funds, Private Equity Funds, Sovereign Debt Funds)
- The new corporations – Investment banking pervades and (more often than not) prevails in big (multinatio-nal) corporations
- The new FIRE – sector and its alleged impact on Anglosaxon capitalism

Misunderstanding Financial Markets

- Replacement of ‘financial markets’ by a global finance industry (integration of core financial actors in a few centralized, specialised exchanges plus global banking / trading networks (OTC-markets for professionals only))
- Explosion of the volume of OTC derivative markets (1500% between 2000 and 2007 for CDOs – CLOs – CDSs volumes)
- Financial bricolage – producing volumes, complexity (new markets, new assets, new opportunities) by banks, their spv’s plus independent agencies plus investors (and their agencies, trusts)
- The emergence and rise to power of new intermediaries (analysts, financial engineers, rating agencies)

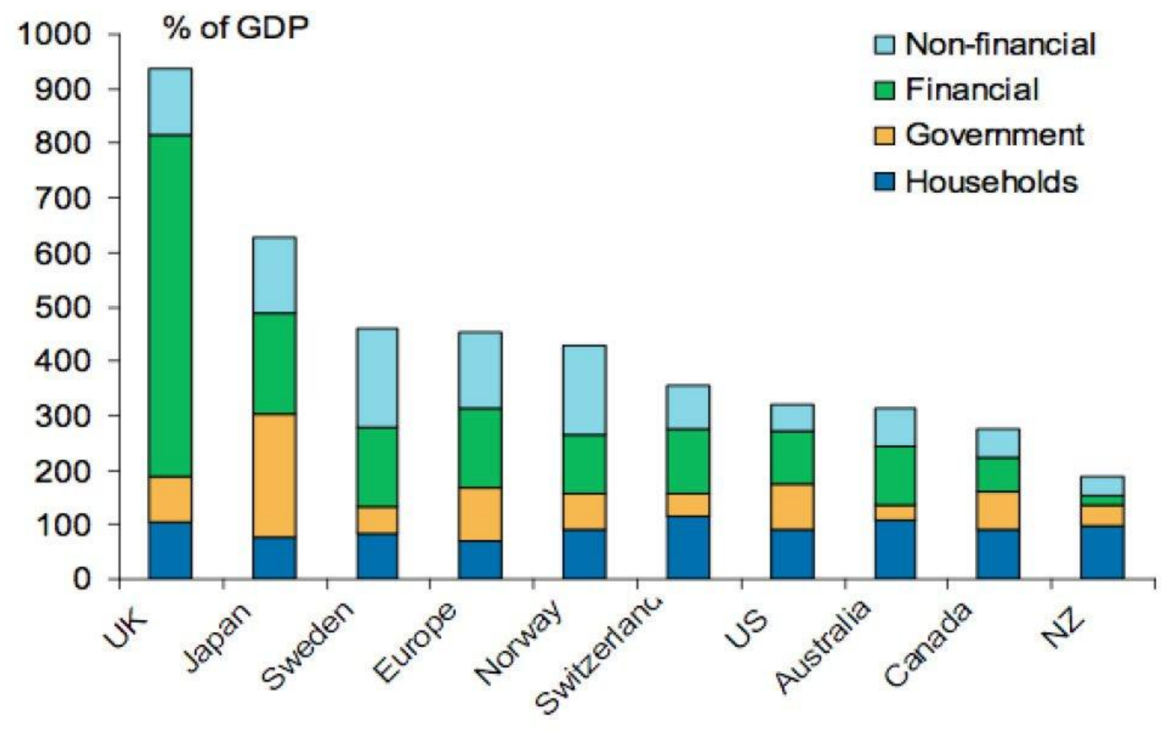
Sovereign debt in the Era of Financialisation

- Traditional government bond markets were simple:
- 1. Central Bank, Treasury, Government Financial Agents, Private Banks (consortia)
- 2. Secondary Bond Markets (Intermediaries, Institutional Investors)
- Recent changes: Sovereign Debt (Gilts) turned into another financial asset (in the hands of professional investors, highly volatile, increasingly speculative, bent on high yields) – plus corollaries DSWs
- Public credit (hence: money in circulation and in reserve) has become dependent upon contemporary financial markets
- The stable cornerstone of the financial markets as we knew them has been undermined
- Speculation in sovereign debt linked with currency speculation
- A dangerous turn: Public debt / credit still the base for mountains of private (financial, household) debt

The actual structure of debt

Exhibit 1

G10 Debt Distribution



Source: Haver Analytics, Morgan Stanley Research