Austeria

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Austeria

In a post at the [Center for International Finance & Development] at the University of Iowa College of Law, we find:

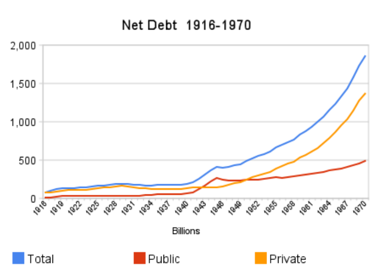
> *Do not be mistaken, there is still hardship in Africa, but a recent report has carefully examined and explained why the African economy has the potential to thrive. Africa has an abundance of natural resources as well as human capital. Furthermore, African economies were more resilient through the worldwide recession of 2009 than many more developed economies . This resilience may have proven to investors that the African economy is not as risky as was once thought, resulting in an increased willingness to invest.*

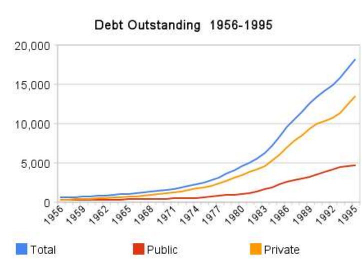
My gut reaction: Well, they must not have much debt, because it's debt that holds an economy down. If they were "more resilient through the worldwide recession" -- if they can bounce back quicker -- then I expect they have less debt.

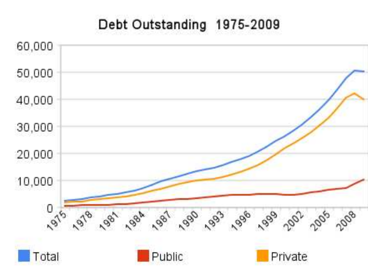
Sound crazy? I know: Bono and Africa, Zimbabwe and hyperinflation, and 20 million Google hits for *DEBT AFRICA*. I know. Maybe they have a lot of government debt over there. But I expect they do not have a lot of private-sector debt, or their economy couldn't bounce back.

It's just a gut reaction: I think it works like that in Africa because it works like that here in the States. At least, I think it works like that here in the States.

That's when I decided to have a look at the numbers on debt in the U.S. economy.





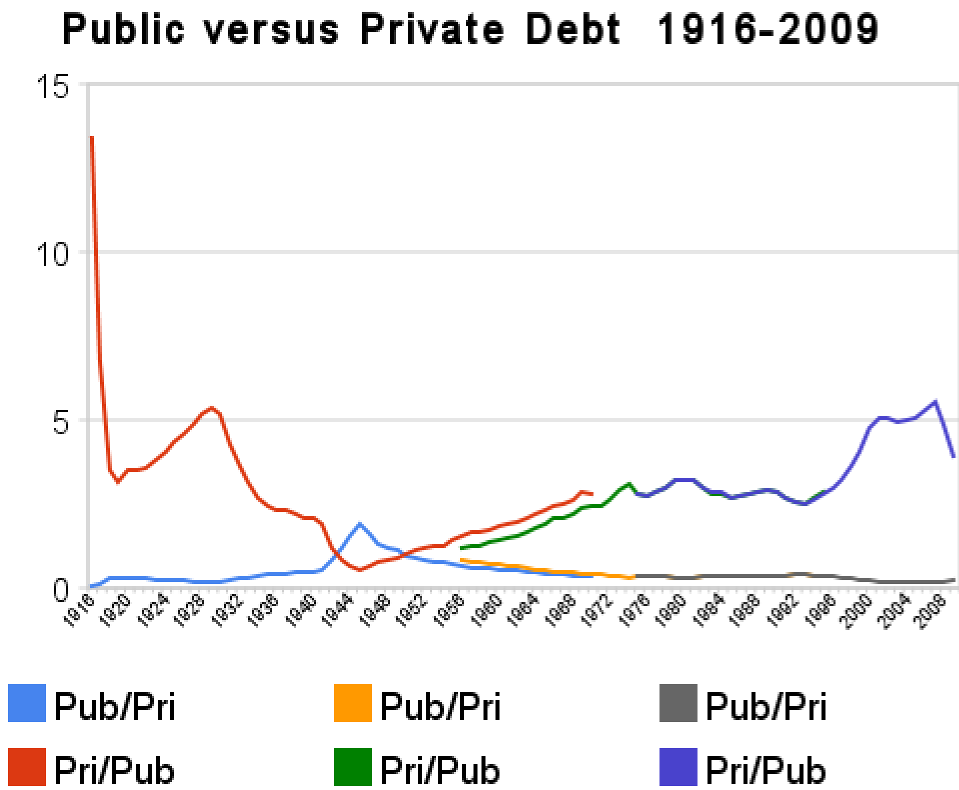


Three data sources, three graphs. One for the period 1916-1970, one for 1956-1995, and one for 1975-2009. They all look the same, don't they? A little wiggle in one, for World War II. A little whoopsie in another, for the recent Paulson Crisis. Other than that, it's all up, up, and up.

Simplify these graphs by eliminating the highest line (total debt) from each. That leaves us with public debt -- federal, state, and local, combined -- and private debt. Private debt here is the debt of households, non-financial businesses, and financial businesses, combined.

My intent is to compare the public and private components of total debt: To see the numbers for the public debt in comparison to private debt. And to see the numbers for private debt, relative to public debt. One hopes these comparisons may offer some perspective on the debt problem.

Together, the three sources provide overlapping data for the period from 1916 to 2009. Combine the three into one graph, we can get a long-term picture of debt in the U.S. economy.



You may notice some mismatches in this graph. In particular, the oldest numbers are “net debt.” The two newer sources provide figures for “debt outstanding.” Between 1956 and 1970 the numbers are similar (the red and green trend-lines run parallel) but they do not mesh precisely. In contrast, the two “debt outstanding” data-sets are a good match for the full length of their 1975-1995 overlap.

Starting at the left we have red and blue lines. The red is total U.S. private debt relative to total U.S. public (federal, state and local) debt. The red line starts around 13.4, meaning there was $13.40 of private debt for each dollar of public debt in 1916. Government debt was very low at that point, making private debt look exceptionally high.

More significant than the height of the red line is how fast it falls. Federal spending grew rapidly during World War I, and the increase in government debt, though it appears slight on the blue line, was enough to bring the red line down to about 3.5 ($3.50 of private debt per dollar of public debt) by 1918.

The bustling economy of the Roaring '20s is visible as the red line climbs quickly to a little over $5 (1929). The line then drops as private debt declines during and after the Great Depression -- quickly until 1934, then slowly, then quickly again during WWII. During the Depression, the blue (public debt) line rises only a little until World War II. Then it ramps upward, crossing the red (private debt) line.

After World War II, public debt (the blue line) gradually falls. The second set of data begins with the gold line in 1956, and though the numbers do not match perfectly, the same downward trend is visible.

After World War II, the increase in private debt (the red line) resumes. The second set of data begins with the green line. As noted, the red and green lines are different, meaning the two sets of debt numbers are not identical. However, those lines do run parallel, meaning the two sets of numbers show the same trend.

The red-green overlap -- in fact almost the whole of that long upward trend -- occurs during the so-called "golden age of post-war capitalism"[1] (from 1947 to 1973) when economic growth was exceptionally good. Private debt (relative to public) increased consistently. Public debt (relative to private) declined persistently.

At the end of the “golden age” we see the end of the consistent increase of private debt. The large burden of private debt -- specifically, the cost associated with that debt -- was the problem that ended the “golden age.”

This effect of excessive debt was what I had in mind when I said of Africa: “I expect they do not have a lot of private-sector debt, or their economy couldn’t bounce back.” (I’d like to say for sure that this is true, but I find no information on African domestic private debt. Oh, there is plenty on the Internet regarding *public* debt, and plenty about *external* debt, and plenty about debt problems in Africa, but nothing about domestic private debt.)

Following the "golden age" increase of private-sector debt, we find twenty years of rough stability stretching from 1973 to 1993. This period includes not only the slow death of the Keynesian era, but also the rise of Reaganomics.

Then from 1993 to 2001 we see a dramatic doubling of private debt relative to public -- from $2.50 to $5. This increase occurs during a decade “reminiscent of the golden age”[2], during which federal deficits were reduced and the federal budget came briefly into balance. In these years, as in the “golden age,” we find economic growth associated with increasing private-sector debt. But as in the “golden age,” the process is ultimately self-defeating when the growing debt eventually becomes an unsustainable burden.

A few tentative conclusions arise from this look at 94 years of debt trends:

1. Periods of economic growth are associated with increasing accumulations of private debt. We see this during the Roaring 20s and again in the 1947-1973 “golden age” and again in the 1990s when the federal budget came briefly into balance.

2. Great accumulations of private debt are associated with the endings of economic growth. We see this in 1929 and in 1973 and in 2001 and in 2008.

3. More tenuously, one may observe that at the level $2.50, private debt (relative to public) hinders growth, and at the level $5 it results in crisis and decline.

In general, let us say that the increasing reliance on credit leads to strong economic growth up to the point where a "Laffer Limit" is reached. Beyond that point, the accumulation of private-sector debt overpowers the beneficial effects of credit use, and weakness in the economy becomes the normal condition.

In summary, the great burden of debt in our economy since the 1970s -- the burden hindering growth -- is the burden of private-sector debt. Public debt is insignificant by comparison.

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The New Arthurian Economics   http://newarthurianeconomics.blogspot.com/

Footnotes

1. The Real Economic Crisis, by Dean Baker and John Schmitt. *The Guardian Unlimited*, October 14, 2007. See http://www.cepr.net/index.php/op-eds-&-columns/op-eds-&-columns/the-real-economic-crisis/

2. ibid.

3. Milton Friedman, Free to Choose. Chapter 3: The Anatomy of Crisis.

Sources

From this site: http://www.federalreserve.gov/releases/z1/

Flow of Funds Accounts of the United States

1. The June 10, 2010 release for "Debt growth, borrowing and debt outstanding tables" PDF. This file covers the years 1975 through 2009.

2. The September 12, 1996 release for "Debt growth, borrowing and debt outstanding tables" PDF. This fole covers the years 1956 through 1995.

From this site: http://www.census.gov/prod/www/abs/statab.html

Bicentennial Edition: Historical Statistics of the United States, Colonial Times to 1970.

I downloaded both ZIPs. The"net debt" data comes from Series X 393-409 in Part 2.