

Indebtedness and Mercantilism

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Summary: In a closed economy, the growth of the GDP is equal to the net indebtedness (the increase of indebtedness) of its agents from one period to another, which allows current demand to be greater than the income of the preceding quarter. In an open economy, we must add to that the net indebtedness of the totality of foreign agents in operation: the currencies corresponding to the foreign trade balance. Depending on the sign of these two kinds of net indebtedness, positive or negative, a classification of countries can be made: mainly mercantilist countries that enjoy a foreign surplus, on the one hand, and “Keynesian” countries running a deficit, whose growth is founded upon domestic demand, on the other hand.

Key words: Foreign trade, Mercantilism, Net indebtedness, Domestic demand.

JEL: E01, E29, F43, F53.

Introduction

The present study constitutes a complement to the very important contribution made by Antoine Brunet, “A Pertinent Analytic Key to Correctly Measure Contributions to Growth in Gross Domestic Product”, the contents of which are accepted herein. This study, however, tries to enrich the former on two levels: first, by giving a clearer and more central place to the notion of indebtedness, and second, by advancing a little further along the path of country classification related to the periods in question.

1. Antoine Brunet’s contribution; rejection of the OECD method and its alternative

The «OECD» breakdown $\Delta\text{GDP} = \Delta\text{TDD} + \Delta\text{TFB}$, in which TDD is total domestic demand and TFB is foreign trade balance, is justifiably criticized because it leads to non-significant results, to the extent that the two terms on the

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right of this accounting identity are made to play an explanatory role. The alternative that Brunet proposes is very pertinent and permits us to analyze the growth of different countries. The equation breaks down as follows:

$$\Delta\text{GDP}/\text{GDP}_{n-1} = (\text{TDD}_n - \text{GDP}_{n-1})/\text{GDP}_{n-1} + (\text{FTB}_n)/\text{GDP}_{n-1}$$

From there, the author notes that “to dope the overall demand addressed to it, a country C can, in reality, solicit two great registers and only two :

1. A country can go capture demand elsewhere (...)
2. A country can go capture demand in another timeframe (...) by allowing its nationals to borrow more overall than they save...”

It is this mode of presentation (space and time) that poses a problem. We think that the two terms to the right in the equality equation which precedes are of the same nature, since they represent net indebtedness.

2. The meaning of (TDD_n - GDP_{n-1}): Growth in a closed or self-sufficient economy

Let us consider a closed economy in which demand determines production, hence income for each quarter. In current quarter n, all economic agents taken as a set can spend precisely the amount of their income from the preceding period (n-1), or much more or much less. How can one spend “more than one earns”? Nothing is easier: all one has to do is borrowing. If demand in quarter n (TDD_n), is greater than income earned during the previous quarter (GDP_{n-1}), it follows that the increase of indebtedness of the economic agents during this period is greater than their savings: the net indebtedness of these economic agents over the course of period n is positive. So we can write the equation as follows:

$$I_{n-1} + \text{net indebtedness} \stackrel{?}{=} \text{TDD}_n$$

Net indebtedness determines demand. Since, moreover, income realized in the period n-1) is equal to production, $I_{n-1} = \text{GDP}_{n-1}$, we obtain the following:

$$\text{net indebtedness} = \text{TDD}_n - \text{GDP}_{n-1}$$

And because $\text{TDD}_n = \text{GDP}_n$, demand determines production, we can write the equation :

$$\Delta\text{GDP} \stackrel{?}{=} \text{net indebtedness}$$

The net indebtedness of the economic agents over the course of period n explains growth. That is made possible thanks to monetary creation. In Brunet’s identity equation:

$$\Delta\text{GDP} = \text{TDD}_n - \text{GDP}_{n-1}$$

Certain economic agents are in debt vis-à-vis other agents; however, from the viewpoint of the economy as a whole, there is net indebtedness of the entire set of economic agents vis-à-vis themselves, i.e., it is a «domestic» net indebtedness because, by hypothesis, we are in a closed economy.

3. Opening up the economy

If there is an opening of the economy, to the preceding net indebtedness a foreign net indebtedness is going to be added to it. What, then, is this “net foreign indebtedness”? It is simply the import-export balance. If a country under consideration has a commercial surplus for its foreign exchange, that means that it will receive currencies. What do these currencies represent? Foreign credits. Consequently, there is net foreign indebtedness towards the country in consideration.

Demand, no longer external but “total”, which addresses the productive system of a country under observation, can formally be put down as “domestic” demand in case of a closed economy.

$$D_n \text{ (total demand)} = \text{GDP}_{n-1} + \text{net indebtedness}$$

Here, net indebtedness is the sum of the two terms: on the one hand, the net indebtedness of «domestic» economic agents (towards themselves), and on the other hand, net indebtedness of foreign economic agents (towards a country under consideration).

The equation can be written as follows:

$$\Delta \text{GDP} = \text{net indebtedness of the entire set of those from whom demand rises}$$

Total demand for quarter n , which determines a production equal to itself (GDP_n) can be written:

$$\text{GDP}_n = \text{GDP}_{n-1} + (\text{TDD}_n - \text{GDP}_{n-1}) + (\text{EXP}_n - \text{IMP}_n)$$

Or else:

$$\Delta \text{GDP} = (\text{TDD}_n - \text{GDP}_{n-1}) + \text{FTB}_n$$

The growth in GDP appears as the sum of the net indebtedness of both groups of agents.

- The net indebtedness of the agents of a country under consideration (insofar as they are creating demand) vis-à-vis themselves;
- The net indebtedness of foreign agents creating demand: when the foreign trade balance is positive, the foreign entity is indebted vis-à-vis the country under consideration.

4. Whose indebtedness, vis-à-vis whom?

The two kinds of net indebtedness envisaged in the preceding section have highly different implications concerning the economic strategy of a country.

For a given country, the potential indebtedness for the rest of the world toward that country has no other limits than its production capacity. Domestic indebtedness, on the other hand, has its limits.

Hence, growth founded on consistent foreign surpluses can be stronger than growth founded on domestic indebtedness: indeed, the economy can be running full tilt without there being a need to increase salaries to stimulate domestic demand. Such an economy is ever more «competitive»; everything else being equal; moreover, it tends to have relatively weak salaries and an underestimated unemployment rate, even without “monetary manipulation”.¹ The growth rate, which is high, is accompanied by an equally high rate of domestic demand, even when the net domestic indebtedness, quarter after quarter, tends to be negative. In a fashion, it’s a question of what we could call “ideal” growth, but which nonetheless is marred by a major flaw: it relies on the deficit of others, and in a certain way, on a permanent “hostility” or “aggressiveness” towards the latter.

In opposition to this situation, growth founded upon domestic indebtedness and a negative foreign trade balance can only be, generally speaking, relatively weak; over the long term, it is unsustainable. Indeed, if, rather than the indebtedness of the economic agents (domestic or foreign) vis-à-vis a country under observation, we look at the net indebtedness of the economic agents from country under consideration (in regard to itself and in regard to the rest of the world), we obtain:

$$\begin{array}{l} \text{Net indebtedness of} \\ \text{«domestic» agents} \end{array} = \begin{array}{l} \text{Net indebtedness} \\ \text{vis-à-vis their} \\ \text{country} \end{array} + \begin{array}{l} \text{Net indebtedness vis-} \\ \text{à-vis foreign} \\ \text{countries} \end{array}$$

$$\begin{array}{l} \text{Net indebtedness of} \\ \text{«domestic» agents} \end{array} = (\text{TDD}_n - \text{GDP}_{n-1}) - \text{FTB}_n$$

In order to situate the importance of the problem, let us imagine the case of an economy growing at the rate of 0.75% per year, with a net domestic indebtedness of 6.75% and a foreign exchange balance equal to - 6% per quarter.

¹ In the monetary adjustments made in the 50’s, 60’s or 70’s, the German currency had to appreciate sharply each time, while the French currency, on the contrary, underwent devaluation over and over.

In such a configuration, the agents who take on debt in this country do so to the tune of 12.75% of GDP, quarter after quarter. That situation cannot endure very long! In a few years, 100%, or even more, of GDP could be reached.

5. Countries can be classed according to their form of net indebtedness

Countries can be classed according to the sign, positive or negative, of their two forms of net indebtedness. A table with four boxes defining the four classes of countries is obtained.

5.1 Mercantilist countries

The balance of their foreign exchanges is strongly positive and, in one way or another, this results in a negative net domestic indebtedness (savings are high). The growth authorized by such a configuration can be strong as well, and be automatically accompanied by high growth of domestic demand. “Mercantilist” growth is not growth which comes from abroad to the detriment of the home country: instead, it is growth that is at one and the same time foreign and domestic.

It must be emphasized that the policy undermining such growth is an aggressive one vis-à-vis other countries, which it condemns to deindustrialization, unemployment, growing private and public deficits, the search for their own “home-grown” expedients in monetary and budgetary policy in order to face an ever more marked dependency towards their “mercantilist” partners. This is also a policy of battle vis-à-vis the working world on the domestic level: choosing mercantilist growth means salary/profit sharing of the national income for the benefit of capital (salaries represent less than 50% of GDP in China), whereas abroad, the countries that fall victim to mercantilist practices register repeated deficits and loss of competitiveness for their businesses in international competition, which in turn puts strong pressure on salaries, tending to make them go down.

In a context of deindustrialization where the «foreign restraint» is very real – and that goes for all countries, even the big ones – weakness in growth does not result from low salaries – monetary creation is pushed to the limits and even beyond! – but comes from the loss of competitiveness vis-à-vis the mercantilist countries and thus from the salary levels and the exchange rates practiced by the latter.

The group of mercantilists who enjoy large commercial surpluses can even be broken down into two subgroups: the «real» mercantilist countries – by which we mean the countries that make these recurring commercial surpluses, thanks to a policy deliberately set up for such – on the one hand, and “countries

of independent means”, on the other hand. The latter combine a largely positive foreign balance of payments, founded most often on the exploitation of non-renewable natural resources, with high savings, higher than the net indebtedness of domestic economic agents. These “countries of independent means”, which hold immense currency reserves, are mercantilist not by the nature of their politics but, in some way, “naturally”, by the reflection of their resources.

5.2 «Keynesian countries»

At the opposite pole to the «mercantilist» countries are found their «victims» (often consentingly so): countries that compensate for a more or less high foreign deficit by monetary creation and indebtedness, so that their rate of growth can, in spite of everything, be positive. We shall call these countries «Keynesian» countries; the expression suggested by Emmanuel Todd (2002): alongside those countries with surpluses in production and foreign exchange are to be found “last-resort consumer” countries, at the head of which is found the United States. These countries have strongly positive indebtedness; at the opposite of the mercantilist countries which have a very strong saving (about 50% in the case of China today or Japan during the 1960’s); this group of countries has a very low savings rate, indeed, almost none. Of course, there is a necessary relationship between the two groups of countries.

This “model” for development is often extolled by a number of analysts: world growth is supposedly fuelled by the “grasshoppers” (i.e., those who spend with no thought of tomorrow) in these countries; but how can we avoid seeing the profoundly “pathological” nature of the relationship that binds the United States hand-and-foot to China, the latter forcing the former to take headlong flight into indebtedness?

Within this group that combines domestic and foreign indebtedness, two rather peculiar subgroups emerge. The subgroup of countries deliberately choosing a policy of excessive external indebtedness with the intention of not honoring their debts in the end; that could concern the irresponsible oligarchies in power who do not hesitate to sacrifice their countries’ long-term interests on the alter of their own immediate, often Mafia-like interests; that could also concern a country borrowing heavily abroad with the firm intention of never repaying its debts, thanks to the war it is preparing for and which it hopes to win: this was exactly the strategy of Nazi-Germany.

Finally, certain countries, which have a highly negative foreign trade balance, are rapidly developing, thanks in particular to foreign investment and capital; this was the case of Russia in the two decades preceding the First World War, and, closer to us in time, the case of the Balkans at the beginning of the 21st century. Obviously, such a development has absolutely nothing “pathological” about it.

5.3 Countries in a transitory phase or in crisis

The other two classes of countries correspond to the cases on the second diagonal: the group of countries whose two ratios are positive, and that of those whose two ratios are negative. The hypothesis we are forming here is that, in one case as in the other, countries that find themselves in one or the other case are in a transitory situation. “Doubly positive” countries have rather high growth rates and are both mercantilist and “Keynesian”; all the same, such a configuration is not stable; it concerns countries that are changing categories, moving, for example, from the group of mercantilist countries to that of countries “of independent means”; such was probably the case of the United States in the 1950’s, when their foreign commerce tended to experience a dwindling surplus (before becoming negative), a factor which stimulated domestic demand more and more.

“Doubly negative” countries evidently have negative growth rates and are in crisis. In this box are to be found the former east-bloc countries that were “in transition” in the 1990’s as well as European countries in recession in the beginning of 2009.

5.4 Country classification and world dynamics

The different categories for countries, and the different countries, which have been considered herein fit into the boxes of the Table 1.

Table 1: Countries classifications

	FTB>0	FTB<0
$TDD_n - GDP_{n-1} > 0$	<u>Countries in a transitory phase:</u> Passing from one category to another ; example, USA in the 1950’s	<u>“Keynesian” countries</u> USA for the last 40 years, Great Britain for the last 60 years (with the exception of the Thatcher episode), post 1980 Spain, Italy, and France
$TDD_n - GDP_{n-1} < 0$	<u>“Mercantilist” Countries</u> a) countries pursuing a mercantilist policy : pre 1960 USA, Japan, Korea, Taiwan, Germany, Switzerland, and China b) countries «of independent means»	<u>Countries in crisis</u> Former east-bloc countries «in transition»in the 90’s, European countries in recession in 2009, etc.

Source: Author’s classification.

It is clearly evident that world dynamics are the product of relations between the first two groups of countries: on the one hand, mercantilist countries and on the other, Keynesian countries. Some analysts claim that the debtors are in the more comfortable position; they would have us deduce that the deficit towards China, which contributes to run these debtors deeper and deeper in the red, would actually secure them a more «comfortable» position! Conversely, it is suitable to recognize that countries having long tasted the headiness of excessive domestic and foreign indebtedness have no other choice but to fall back upon the austere virtues of saving or military ventures to escape from the economic colonization flowing from the foreign debts they have contracted, except to recognize that it is no longer possible, at least not desirable, to continue practicing economic exchanges in a mercantilist world in which certain countries – principally China – practice exchange dumping with the effect of destabilizing the rest of the world.

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