

Book Review

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The Global Debt Trap: How to Escape the Danger and Build a Fortune

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This is a translation of the German edition of the book published in 2010. The book has forwarding by famous New York Times reporter Martin D Weiss. Dr. Weiss noted it as a sequel to the authors' bestselling book, Das Greenspan Dossier, published in Germany in 2004. In that dossier the authors predicted the US real estate bubble and they wrote; "it will not only trigger a recession and a stock market crash, but it endangers the entire financial system...." Surprisingly they also wrote in the German edition in 2009 about the "quantitative easing" or money printing by Fed Chairman Ben Bernanke and the sovereign debt crisis later on faced by Greece, Spain or Portugal. This forward by Dr. Weiss, covered the main thesis that monetary and fiscal policy failures contributed to the crisis and that it described in the book. Before that there is an introductory chapter and it covered the history of increase in debts in some major countries and a path of growth in debts with and without some efforts to control it in major economies.

It is stated that global debt trap has been driving policy-making these days. The Table 1.1 gives evidence on the global debt-trap as may be seen below for some major countries:

TABLE 1

Government debt as a percentage of GDP, 2007-2011

	2007	2010	2011
Japan	167	199	205
United Kingdom	47	82	91
USA	62	90	95

Japan has the biggest government debt problem and it financed its debt almost exclusively from the savings of its own people. Whereas USA relied mostly on foreign lenders, most of them from the emerging economies such as China, Middle Eastern countries and Japan.

The book presents debt-related trends for these countries. It shows if no step is taken to adjust the rising trend then by 2040 public debt will reach 450% in Japan, USA and UK. With gradual adjustments it will reach 280%, 160% and 150% respectively in Japan, UK and USA. The Bank of International Settlements (BIS) “assumes that governments must and will take steps to change the course. The only questions are: how, how much and when?”

The next section provides some light on what will actually happen? And the authors listed six escape routes and termed them as hatches. These are miracle economic growth, major interest rate cuts, and bail-out by other governments, outright defaults, austerity and money printing. After briefly explaining the pros and cons of the escape-hatches the authors came to the conclusion that the last one, printing of money to buy back debts and inflate the debt away and put the burden on future generations but with the danger of hyperinflation in the corner and attendant social upheaval that happened in the past in Germany in particular.

In the following paragraphs, the contents of the book are described by each chapter in an ascending order.

Chapter 1: Why the debt crisis was predictable.

The authors based their analysis by tracing the huge differences between classical liberal thinking and Keynesianism. The authors relied on the insights of the Australian School of economics, mainly that of FA von Hayek that extended economic analysis to the realm of freedom of individuals, to freedom of owning property and means of production and freedom of contracts. They wrote “individual freedom continually faces a series of specific threats and that the greater threat to individual freedom comes not from other individuals but rather from powerful organizations, mightiest of which is the state”. They refer to the famous book of Hayek “road to serfdom” that elaborated on the process through which states have abolished freedom and established slavery, and mentioned giving power to the state to multiply currency at will and encourage politicians to adopt policies to satisfy greed of the few.

“ The former President George W. Bush and the neo-conservatives, despite all their rhetoric to the contrary , were in fact out and out Keynesians” they wrote they adopted monetary and fiscal policies and accumulated huge public

debt that resulted in fiscal binds-clips and sequestration policies by the Congress under Obama administration. They are now trying to adopt certain budget cuts, limited increase taxes on the rich class and limit public borrowing so as to restrain rising public debts that amounted to over \$13 trillion in 2012.”

Chapter 2: Real Estate, Banks, Bubbles, and Debt.

This chapter traced the real estate bubble and depicted in Figure 2.1 (of the book) Median Home Prices as a Multiple of Household Income. It was shown that from 1973 to 2000 house prices hovered around 3.5 times of household incomes a year. After 2000 it started climbing upward and reached the highest level at 4.8 times, a rise of about 40% in 2005 and there after it started sliding down to 3.6 times in 2010. It is now a common knowledge as to how the two public sector finance companies Fanny-May and Freddy-May refinanced mortgage assets from retail banks that lent money to dubious borrowers with all kinds of attractive facilities, even without zero equity from the house buyer. Economists called these rise in house prices as leading to wealth effects that allowed consumers to borrow more against higher home prices and went for a push to consumer demand. Trillion dollars flowed into the consumer economy, the authors noted.

Chapter 3: The Great Money Game.

In this chapter the authors traced the history of money and the process through which banks create money supply. The fractional reserve banking is at the heart of the inflationary evil, they started a section. Here they wrote: “In principle, therefore, this concept today called the fractional reserve banking--runs absolutely counter to the interest of the bank depositors and provides exclusively for the enrichment of the bankers.” For this reason this early form double-leveraging was regarded not only as immoral by the Church but was widely forbidden throughout much of the history of finance. Islam in particular considered taking interest as a sin from its beginning and therefore Muslim countries did not see expansion of the modern banking for many years. They have of course started Sharia-based banking in many Muslim countries and volume of lending under this system is reported to have reached over \$6.0 trillion and growing rapidly.

In centralizing money-creation in the hands of the banks under supervision of central banks, the authors noted the free markets proponents have actually fulfilled the demands made by Karl Marx and F Engels besides the other demand, that is, “for heavy progressive or graduated income tax”. The authors noted relatively high income taxes in the developed countries as giving too much power

to the governments to spend as suggested by the Marxists and concluded that because of such high taxes “it has never been as difficult to become prosperous and build wealth—through honest work as it is today.” This conclusion seems to go against the rising concentration of wealth in top 5% of the people and their strategy to hide their money in many off-shore tax havens. This money contributes little to increase real production and recent estimates put the amount of funds reaching \$32 trillion. Needless to point out those even developing countries poor as it is like Bangladesh is also faced the problem from the flight of capital to secret bank accounts in the west. The recent banking crisis in Cyprus is an example of fund-transfer from many countries to this small island nation, most of the fund came from the Russians, newly rich classes as they did not feel safe in their own country. Imagine if 20% of the amount was realized as taxes it would amount to \$6.4 trillion and reduce the public debt of USA to half allowing the Obama administration to undertake many projects to improve the infrastructure and create thousands of jobs.

Chapter 4: The Road to (hyper) Inflation.

The authors’ main contention in this chapter is that the printing of money is going to create pressure on rising prices once the deflationary tendencies are halted. They gave example from history especially the hyper-inflation in Germany and Brazil. “Inflation does not just happen. It does not fall from the skies. Inflation is man- made. It is the result of conscious political decision” they concluded very rightly. Even in Bangladesh, Bangladesh Bank’s policy of increasing credits to public and private sector contributed to the boom in stock markets and real estates. Inflation rates were pushed to above 12%. When the credit expansion stopped stock market started sliding down and gradually crashed. So was the case with real estates. After two years’ inflation came down under 8% annual rate.

Chapter 5: How could it have come to this?

This chapter reflects on the personalities, such as Paul Volcker, Greenspan, Ben Bernanke, Gross, Either and President Obama and commented that: “the fish stinks from the head down.”

There is also concerns expressed as “Politics can seriously damage your finances, your health, and in extreme cases, our democracy”

Chapter 6: What can you do now?

This chapter tries to predict what is likely to happen, such as threats to individual's property by either of the two ways: forcible expropriation as was done by Marxists states or subtle expropriation by inflation under Keynesians. They have suggested that besides equities, investors should diversify to commodities especially precious metals like gold as hedge against inflation.

Chapter 7: A future retrospective.

It is short note to the current generation of people to seek foundations for a new and better system- that is return to the proven principle of economics for sustainable development for prosperity. The important factor to be mentioned that we must change the politics first and educate the politicians that unless they pay more taxes they cannot ask the people to do so. Borrowing ultimately shifts the burden on the poor and they continue to suffer. It is hoped that the present US administration under Obama and President Oland of France will bring some changes. In the long run we should look to the Islamic world for solutions to the debt problem as they have so far been out of the debt crisis of the magnitude in western countries.

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