

INEQUITY AS A CAUSE OF FINANCIAL AND DEBT CRISIS

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Abstract

There are several reasons for the financial crisis in the USA and the debt crisis in the Eurozone. Initially, imminent reasons for the crisis have been found in the spotlight. Such are the financial deregulation and the problems with secondary mortgage credits. But lately, when it has been seen that despite the huge financial support, the economies in the developed countries haven't made a recovery, the attention has been turned towards the "invisible", towards the causes that have contributed and enabled the "bubble economy" and the indebted countries to be developed, especially in the Eurozone. The growth in inequity in the USA and between separate countries in the EU i.e. in the Eurozone has been treated as a main reason. Although there are more reasons for the inequity, their common denominator is the free market and the distribution of values that are being created, in that sense that the development of relations in the national economies and among themselves, on the basis of free acting on the markets, do not generate sufficiently the final consumption because the share of workers in GDP has been decreased. This necessarily reduces the tendency for spending. The "bubbles" are a consequence of the governmental insistentcies to ease the contradictions between the richer and poorer citizens in the USA and between the wealthier and poorer countries in the Eurozone. For this purpose in the USA, it has been led a relaxed monetary and fiscal policy whereas in the Eurozone, it has been overlooked to the non-compliance of the contractual limits for public expenditure and indebtedness towards abroad.

Introduction

The last financial and economic crisis (2007-2009), generally called global crisis, was most sternly manifested in the developed economies, especially in the USA, but lately, as a debt crisis, it was manifested in the countries of the Eurozone as well. On one hand, the explication for the reasons of provoking the greatest financial and economic crisis after World War II and of the burdens in its overcoming, in an extreme instance in the USA, it was brought down to the deficient expenditure due to the increase in inequality within the society. On the other hand, the debt crisis in Europe is a consequence of the intensively expressed striving of the Eurozone member states, with lower degree of development, for reducing the differences in the expenditure, irrespective of the increase of labor's productivity and the competitiveness of national economies (and definitely as a result of the increase of inequality among separate countries). Despite of the fact that their common denominator is identical, the differences in inequality, in or among the societies, are evident. Even the differences in the way of overcoming the crisis in the USA and the Eurozone, proceed from them.

Inequality as a reason for the crisis in the USA

The depth of crisis in the USA reveals itself in the stunted recovery of the American economy, especially in the decrease of the rate of unemployment, which has outstripped double figures within the reverberation of crisis and even two years after the recovery of economy from recession, it is still over 8 per cent, despite the massive state intervention (with monetary and fiscal measures) to incite the business to increase the economic activity and to reduce the number of the unemployed. For the seriousness of the situation speaks even the fact that the

unsatisfactory reduction of the rate of unemployment is not a consequence of not having means to finance the development, but above all, is due to the distrust of business in the justification of intensifying its own development in terms of deeply indebted families and citizens, in terms of the emphasized need for larger saving and clearing their own debts, and of unpredictable flows of economic activities in the European countries, being the most important foreign economic partners of the USA (due to their determination to overcome the debt crisis through rigorous austerity).

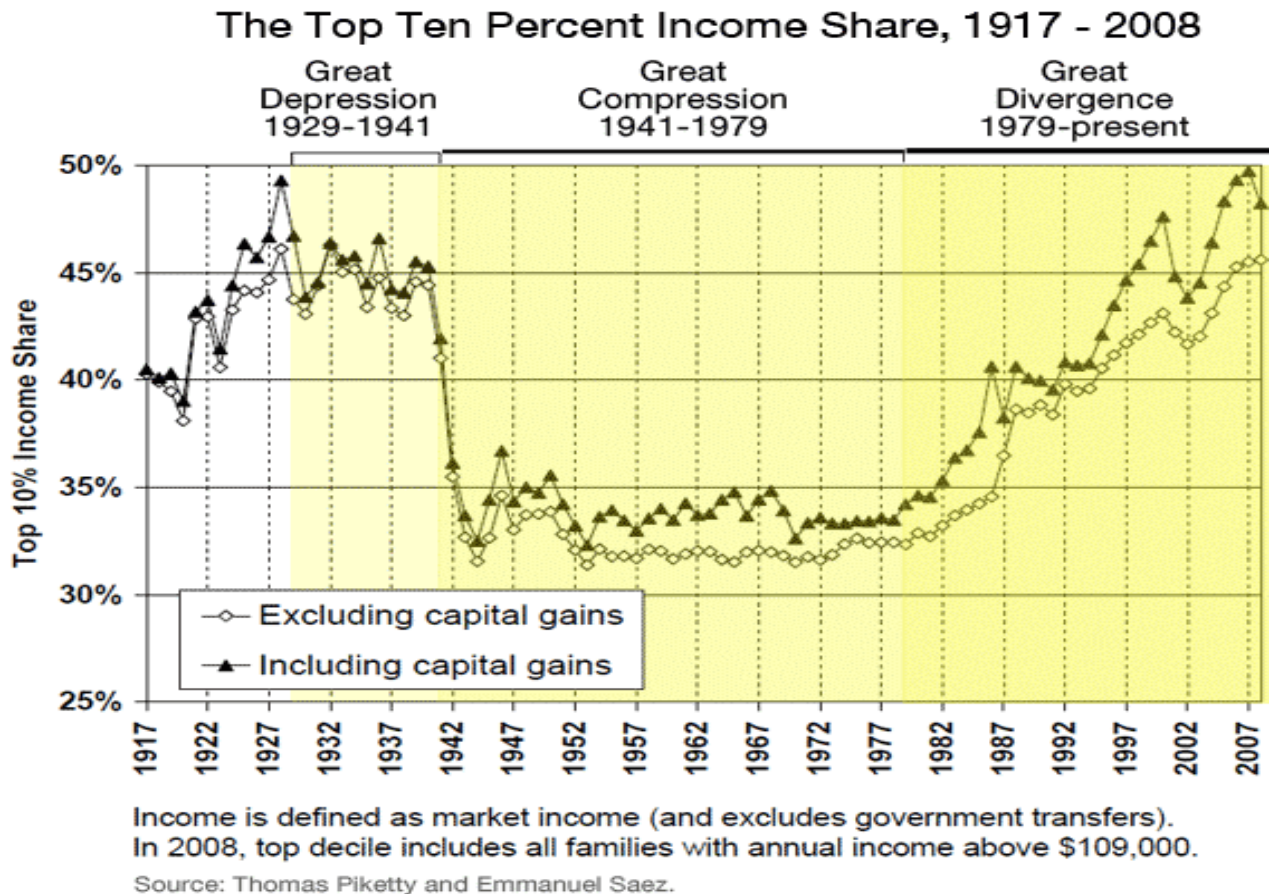
Through this development of events can be seen that the dynamic development of the USA before the crisis, was largely based on unprecedented consumption (regarding the real possibilities of the country). The consumption is enabled by running relaxed monetary and fiscal policy, by maintaining low interest rates, by a constant increase of the budget deficit and by “constructing” the foreign debts. But, one problem is that despite the policy of expansion, the country fell into the greatest crisis after the Great Depression of the 1930s. The recovery of the economy and the bringing of the unemployment down to a pre-crisis level, are still uncertain, despite the unseen measures taken by the arsenal of state intervention, including and the printing of large sums of dollars. On one hand, the crisis has brought into question the opportuneness of the policy of expansion in conditions when the economy is making progress, whereas on the other hand, it has shown its insufficient efficiency in the revival of the economy despite the continuation of more emphasized monetary and fiscal policy of expansion. That is the way it is because the inflationary economy cannot be recovered by larger inflation.

The latest data of reducing the unemployment to 8.3 per cent show that maybe the USA will improve the results in employment by further monetary expansion but it is like that because a good part of the inflationary effects is

prevailed in the other countries through the international role of the dollar. That is a privilege of the countries whose currency performs a function of world money. But it is not without any risk of their further use in that function.

The issue of inequality in the USA is a subject of numerous researches. In most of the researches, it has been pointed out to various reasons for intensifying the process of increasing the inequality throughout the period after the 70s of the last century. Few, however, show various effects of the increase in inequality in the socio-economic development, and rare are those who perceive the inequality as a reason for the appearance of the crisis and as a problem with broader theoretical and practical repercussions. One of them is Nouriel Roubini. The growth of inequality is a key reason for him. He relates it with the global wave of social and political turmoil in many countries in the world, including the USA and shows that the increase of inequality adversely affects the interests and motivation of the investors to broaden the existing and start new businesses, thus having contributed to the decrease of unemployment. Roubini lists several reasons for increasing inequality. However, their common denominator is the free market and the distribution of values that have been created. To him and other authors, it is undeniable that the development of relations within and among the national economies, on the basis of free functioning of the markets, does not create final expenditure enough as a result of decreasing the workers' share in GDP. It is known that this trend, being a common feature of the market economies, has been intensified within the era of Reagan Thatcher (look at the graph). It is a process in which the rich have become even richer whereas the poor – relatively poorer. In the late seventies, 1 per cent of the wealthiest citizens of the USA adopted less than 9 per cent of the total income, whereas in 2007 – 23.5 per cent.

Table 1



Source: Taken from Timothy Noah: The United States of Inequality, The Great Divergence: What's causing America's growing income inequality? September 3, 2010.

There are many data that have been showing increasing of the gap between the rich and the poor both in the developed and less developed economies. The trend is obvious. The increasing of inequality continues even after the overcoming of the recession. In 2010, 1 per cent of the 93 per cent of increased income, created in the USA, in relation to the one in 2009, has fallen to the rich. During the era of Bush, this cipher presented 65 per cent, whereas during the time of Clinton – 45 per cent¹.

¹ Sreven Rattner: The Rich Get Even Richer. The New York Times, 25 March, 2012.

Inequality in the level of development of separate countries as a cause of the debt crisis in the Eurozone

The process of increasing inequality is present even in most of the European countries, members of the European Union and the Eurozone, having less intensity than in the USA. The coefficient Gini, which shows the degree of concentration of income distribution (salaries and other transfers in cash) in a specific country, is higher in the USA than in the European countries. This also refers to the life standard, in which, despite the salaries and transfers, are also included the benefits in the health care and education, that have been provided by the government. There is no doubt that the relatively lower concentration of inequality in separate countries of the Eurozone in relation to the USA, has been contributing to intensify the process of their indebtedness. But, the falling into debt crisis is, above all, a consequence of the large differences in the level of development among separate countries of the Eurozone and of the striving of the less developed ones to approach the level of wealthier countries, at least the one of expenditure. It is not a coincidence that the debt crisis at the level of bankruptcy, occurred within the countries of the Eurozone's peripheries. They have found an excuse for the increase in expenditure above the level of the income, they are generating, in the common destiny of the euro, although there are limits, provided within the rules for functioning of the common currency, which must not be exceeded in order to avoid the undesirable consequences of excessive budget spending and increase in external debt. The budget deficits were limited to 3 per cent of the GDP, whereas the governmental debt - to 60 per cent of the GDP. If the obligations would have been fulfilled strictly, in the next 10 years it would not be possible even theoretically for separate countries to run into crisis and not to accomplish the obligations abroad. The growth of governmental debts by over 100 per cent of annual GDP is a consequence of the

excessive budget deficits in the last period. Most countries of the Eurozone have outstripped the annual limit of 3 per cent several times, whereas Greece has done that nearly five times (14.5 per cent last year). Not to mention the false presentation of the situation in relation to the limits. It is a fact that the penetrating of the limits (without withdrawing any consequences) contributed to the development of debt crisis in separate countries. However, that merely explains the technique how separate countries, penetrating the limits, have fallen into a crisis. The approach to penetrating the limits, definitely, is irrelevant, in reference to the fact that even the best system cannot function effectively if it is not implemented consequently. But, certainly, it is not sufficient for clarifying the reasons for debt crisis in the Eurozone. The debt crisis is a consequence of the inequality within the level of development among the member states of the Eurozone and of the striving of the less developed ones to develop more quickly. A need has been imposed in order to review the limits in relation to the Eurozone, in terms of the functioning of the common currency on the only market. The limits cannot refer to all the members in conditions of inequality. The Eurozone cannot function successfully, if there is no clear policy for decreasing the differences within the level of development among the member states. This problem has been manifested also in the efforts of outstripping the debt crisis. It has come to a confrontation during the first signs of crisis among the countries which were not in a position to service the obligations on time towards abroad and among the countries which should have provided the adequate support in order to save the euro and the Eurozone. After a while, the first sharp remarks about the irresponsible behavior of the indebted countries were replaced with activities of adopting measures to empower the countries in crisis to accomplish their obligations towards abroad, including the writing off of some of the demands. Although indirectly, the indebted countries were also supported by European Central Bank (ECB) by having financed the commercial

banks, granting them means with low interest so that they can buy out bonds from the countries in debt crisis, thus having an influence on decreasing the interests of the bonds they have been issuing. All this indicates that after two years of the breaking out of the debt crisis, on one hand, it has been understood that the member states – the developed and the less developed ones have an interest in saving the euro and the Eurozone, whereas on the other hand, it has been understood that it is necessary to remove the deficiencies in the construction of the Union and the Eurozone for further strengthening of the countries. In order to overcome the crisis, the member states actually have split the responsibility for the occurred situation, but in order to prevent similar occurrences in future, they have to make changes in accordance with the necessity for consequent action on the only market, about what it is needed a coordination and synchronization of the monetary and fiscal policy.

Conclusion

After the World War II, several reasons were given within the analyses of the greatest global financial and economic crisis. Most of them are being associated with the inadequate regulation of financial sphere and the avaricious conduct of the management of financial institutions. It is a fact that the deregulation² within the sphere of finances has accelerated the motion towards crisis. However, it would have come to a crisis even without that lately, due to the objective process of increasing the inequality within and among separate countries. The increase in inequality leads to insufficient final demand. This process in the USA extorted relaxed monetary and fiscal policy which has ended with a crisis in the mortgage credits, enormous budget deficit and high degree of indebtedness. And the debt crisis in the Eurozone is a consequence of inequality, but above all, of the inequality in the level of development between separate member states and of the

² Dani Rodrik: Milton Friedman's Magical Thinking, Project Syndicate, 2011-10-11

striving of the less developed ones to approach the level of wealthier countries, at least the level of consumption. Both brands of inequality are a consequence of the functioning of the free market and they have been manifested strongly within the process of globalization. However, the crisis reminded that the achievement in supporting the objective processes is low, as that one of globalization. The highly liberalized market cannot deal with the problems which it has been generating in the development of national economies and global economy. That is why, it should be abandoned the models of state's non-interference in economic matters. It has to be requested a real balance between the role of the market and of the country, whereas in the same time, it has to be avoided the danger of suppressing the functioning of market regularities.

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