Debtors' Prison by Robert Kuttner

Economic history is filled with bouts of financial euphoria followed by painful mornings after. When nations awake saddled with debts incurred to finance wars, episodes of failed speculation, or grand projects that haven't paid off, they have two choices. Either the creditor class prevails at the expense of everyone else, or governments find ways to reduce the debt burden so that the productive power of the economy can recover.

Creditors—the *rentier* class in classic usage—are usually the wealthy and the powerful. Debtors, almost by definition, have scant resources or power. The "money issue" of 19th-century America, about whether credit would be cheap or dear, was also a battle between growth and austerity.

The creditor class views anything less than full debt repayment as the collapse of economic civilization. In fact, however, debts are often not paid in full. In the 20th century, speculators lost fortunes as dozens of nations defaulted on debts. Several 19th-century U.S. states and municipalities defaulted. Losers in wars and revolutions seldom pay debts. (Those czarist bonds have no value except on eBay.) The Brady Plan of the late 1980s paid bondholders of defaulting Third World debtors at about 70 cents on the dollar so that economic growth could resume.

Sometimes, debts simply cannot be paid. That's why debtors' prison was a ruinous idea (except as a deterrent). The real issue is how to restructure debt when it becomes impossible to repay. This is not just a struggle between haves and have-nots but between the claims of the past and the potential of the future.

Debt can be reduced or renounced in ways that are constructive or that add to the chaos. Inflation, for instance, is one way of eroding debt, and a risky one. There can be a calamitously abrupt default (Lehman Brothers) or a careful and beneficial restructuring (General Motors).

Bankruptcy ingeniously provides orderly relief from past debt so that the productive enterprise is not needlessly destroyed. A judge evaluates the assets, liabilities, and viability of an insolvent business. If it is deemed viable, creditors are not permitted to sell off the machinery, but they get paid off at so many cents on the dollar, and the enterprise is restored to constructive use.

American business values the bankruptcy system for its own purposes, even though investors occasionally take a bath. But the same business elite looks askance when others—homeowners, small nations, the entire economic system—seek relief from punishing and economically perverse debt. It is no accident that one of the most astute critics of how the financial collapse has privileged creditors at the expense of everyone else is a leading bankruptcy expert, Professor Elizabeth Warren.

History's two great negative and positive examples of how to deal with unsustainable debt are the periods after the two world wars. At the 1919 Versailles peace conference, the creditor mentality prevailed, and Europe's postwar recovery was aborted. Britain and France imagined they could bleed defeated Germany to pay off their own immense war debts (mostly to the United States). Britain also pursued tight money to keep its own currency valued at prewar levels, in order to protect the creditor class. The policy wrecked the German economy and kept British unemployment above 10 percent for two decades. The great critic of Britain's folly was John Maynard Keynes, then an adviser to the British Treasury. Keynes' 1919 book, *The Economic Consequences of the Peace*, prophetically warned that the policy of squeezing Germany until "the pips squeak" would cause depression and a second war.

After World War II, history gave Keynes a chance do it right. His Bretton Woods system emphasized domestic recovery in the defeated as well as the victorious powers and created a global monetary system in which private financial speculators were denied the power to compel nations to pursue deflation. Our own Federal Reserve combined loose money with tight regulation, so that low interest rates could fund the huge war debt without inviting destructive speculation. Cheap money and expansive investment kept America from sinking back into depression.

Debt politics pits the claims of the past against the productive potential of the future.

Today, that expansionary logic has been reversed and creditors are once again hegemonic. Banks want cheap money for themselves, draconian terms for others. The banker-afflicted European Union is punishing Greece rather than finding a way to let it grow. In the United States, relief is denied to underwater homeowners because debt contracts are sacred, even as the policy prolongs the agony. Everywhere, budget austerity is advertised as the road to growth—though it denies the economy its productive potential.

These issues are treated as either impossibly technical or as non-debatable. They are neither. We need to democratize the money issue once again. TAP