Prospects for the world economy [*]

PAOLO SYLOS LABINI

1. The American economic crisis

In a paper on the prospects facing the world economy that I presented in April 2002 in a Conference organized by the CGIL (the Italian Confederation of Trade Unions) and published in the May 2002 issue of *Il Ponte*, I expressed serious worries about the American economy, which strongly conditions the economies of the other countries, particularly in Europe. Many of the participants thought that my diagnosis was too pessimistic, but up to now the facts have shown that I was right. Today my diagnosis is even more pessimistic but, be it right or wrong, it is founded not on intuitions, but on detailed analysis. Indeed, since I first set out as an economist I have sought to analyze the process of capitalist development which, as Marx maintained and Schumpeter reformulated in original terms, has a cyclical behaviour, passing through phases of prosperity and recession or depression.

For about three years I have been noting certain similarities between the situation that arose in America in the 1920s – a period that ended up in the most serious depression in the history of capitalism – and the situation that has emerged today. The main similarities consist in the importance of certain innovations (electricity and cars in

---

□ Università degli Studi di Roma, Facoltà di Scienze Statistiche, Demografiche e Attuariali, Dipartimento di Scienze Economiche, Roma (Italy); e-mail: paolo.syloslabini@tin.it.

[*] I express my thanks to Pierluigi Ciocca, Luigi Pasinetti and two anonymous referees for their useful observations to a previous draft of this paper and to Carla Russo for her help in the predisposition of diagrams.

I warn the reader that, when I write America, I always mean the United States.

BNL Quarterly Review, no. 226, September 2003.

the 1920s, electronics, information technology and telecommunications in our time); the emergence and diffusion of high and increasing profits, first in the new industries and then in many others; stock exchange speculation, fed not only by high profits, but also by expectations of their rising even higher; short term and long term debts, tied up, for firms, by the opportunities of investing in plant and equipment and, for families, for investment in consumer durables, like houses. Similar phenomena can also be seen in Japan, whose economy, until a few years ago, was the most dynamic in the world.

To interpret the process of cyclical development, as well as the great innovations, three other phenomena deserve particular attention: income distribution, market forms and the sustainability of debts. The driving force of cyclical development is given by innovations: the larger they loom, the more widespread will be the investment opportunities they create, and the more lasting the phase of prosperity. At the same time, however, the stronger the waves of speculation surge, the more frequently managers will err and the greater the debts will grow, and their dimensions, once the prosperity is over, will condition the length of the crisis.

2. Increasing income inequality in the 1920s and 1990s

When income inequality increases at least two problems arise: the demand for consumer goods slows down while speculative operations increase, together with the debts contracted to finance them.

In the 1920s the share of income going to the highest quintile rose by six points, from 48% in 1923 to 56% in 1929 (Sylos Labini 1984, p. 265). From 1992 to 2001 the purchasing power of the lowest median quintile lost 3.6 points, whereas that of the highest quintile gained 0.7 points, so that the gap widened by 4.3 points – no negligible change! (These data, drawn up by the Federal Reserve System, were kindly provided by the Research Department of the Bank of Italy.)

Income inequality increases systematically either as a consequence of fiscal policy or as an effect of great innovations pushing up profits, first in the new industries and then, gradually, in many other industries whose conditions of producing or of selling are affected by

the new industries and the new products. External dynamic economies of a special kind are now at work: profits increase in successive waves, and this gives rise to speculative waves in the stock exchange with their epicentre lying precisely in the innovations. Profits, gains from shares and lavish compensations for managers – especially the top managers – also feed waves of real estate purchase; thus two speculative bubbles appear, one in the stock exchange, the other in the real estate markets. In America the former burst twice, while the latter knew only one abeyance. In the era of globalization the speculative waves spread throughout the industrialized world, but with a certain asynchronism. Moreover, the interests involved are so great that the central bank and major banks, which sometimes join in the speculation themselves, support these waves with their policies, even for a relatively long period. For such reasons speculative bubbles do not burst suddenly, and often reappear. The Wall Street bubble burst once towards the end of 2001, with negative effects on the purchasing power of families. It burst a second time in 2002 but, in more limited dimensions, it then reappeared.

3. Salaries for the top managers of large oligopolistic firms. The behaviour of prices

In the last few years income inequality has increased in America, partly due to a special factor, namely the lavish compensations that top managers of large oligopolistic firms assign themselves in the form of either very high salaries or bonuses or free shares. In several cases these managers have availed themselves of the complicity of important accounting companies, agreeing to manipulate budgets to hide losses resulting from recession or compensations no longer supported by profits. In any case – as I wrote in my monograph on oligopoly (Sylos Labini 1964, p. 103) – the above normal profits of the big oligopolistic corporations at least in part

> "are transformed into high and even rising salaries which corporation managers are in the habit of paying themselves. In a world dominated by large oligopolistic concerns these salaries are not a mere remuneration for the services of men of outstanding or even

> exceptional ability, nor are they in any way related to some fictitious 'marginal productivity' of these services; these salaries do, in effect, incorporate part of the extra profits and are a status symbol (as the sociologists say) of business managers. As such they are almost a 'necessity' of the system. If all the large corporations collude in this respect, the slice of the oligopolistic excess profits channelled to such uses may become quite sizable".

In recession or crisis profits in general and, in particular, those of many large firms plunge to become losses. With low tide the rocks emerge, and fraud is more likely to show up in full daylight. This has occurred in all the industrialized countries but particularly in America, where the large corporations' 'museum of horrors' has made some striking acquisitions (see Appendix). It is as well to point out that transformation of part of the profits into compensations for top managers reduces reserves that are important precisely when an economic storm bursts.

The big firms are in a position to introduce all sorts of innovations, small and large, and, within certain limits, to regulate prices. Thus, when productivity increases more than the increase in demand, prices may remain stable while employment decreases in proportion to the excess increase in productivity. This means that in large firms prices become more rigid downwards, and employment more flexible.

As a rule the big firms operate in a regime of concentrated or mixed oligopoly. The latter market form, where concentration and differentiation coexist, prevails in various industries producing consumer durables, in the credit sector and in the sector of large scale commercial distribution, whereas in the industries producing nondurable consumer goods and in retail trade differentiated oligopoly is the rule. In all three cases prices can be said to show a remarkable downward rigidity, with the warning that in retail trade efficiency increases very slowly; therefore in countries where retail trade prevails and big stores are rare, commercial margins and consumer prices tend to increase more than in the other countries. The cost of living includes not only the prices of consumer goods and private services, but also those of public services, tariffs and rents, whose variations follow a different logic.

Competition in the classical sense – free entry – prevails in the markets for agricultural products and in many markets for mineral products. Here prices show a relatively large flexibility in both the

upward and downward direction, even when they meet with limits that did not exist in the great depression, such as are determined by public support for agricultural produce and new types of cartels in mineral products.

Let us get the picture into better perspective. The First World War speeded up structural changes in industry that were already long under way, and the large oligopolistic firms, which were the exception at the beginning of the century, had become the rule in various industries due to a process of concentration that found driving force in the economies of scale promoted by innovations of various kinds. Moreover, as newspapers and radio found a vast public, advertising received a huge boost which, together with the increase in per capita income, favoured increasing differentiation in products and services. Nowadays in industry and trade prices depend on changes in costs, not in demand (Sylos Labini 1982). In the 1930s the sharp fall in prices both at the production and the consumption level (about 25%) reflected the fall in the cost of labour (20%) and the slump in raw material prices (45%). Today in the negative conjuncture raw material prices fall, but within limits – much less than in the 1930s; as for the cost of labour, it diminishes very little if at all thanks to the trade unions and differentiation of labour services.

We have, then, to consider the prices of three categories of goods: finished industrial goods, consumer goods and agricultural and mineral raw materials, noting that the price of oil – the most important source of energy – is conditioned by political and military events, and not only by market forces, thus showing unpredictable oscillations.

In such conditions, whereas deflation can certainly occur in terms of reduction in demand, in terms of a sharp reduction in prices it is a highly unlikely occurrence. Production prices can fall within limits, as happened in America in 2002 (–1.4%), and raw material prices can also drop (they have, by –6%). The price of oil has oscillated and the prices of consumer goods increased, though very limitedly (1.6%): today a sharp fall in such prices can be ruled out.

Houses represent a special problem: in certain periods dominated by speculative operations their prices can fall quite suddenly. Today a number of observers are closely following the behaviour of estate markets in the industrialized countries, also in view of the possible collateral effects of a slump in the price of houses.

4. Debts

In the case of America today we have to consider four types of debts: public debt, debts of firms, family debts and foreign debt. The distinction between short and long term debts is of fundamental importance; when long term debts become very hard to liquidate they represent special problems – they are called 'immobilizations'. In America private debts and foreign debt have reached dangerous levels, whereas the public debt has been giving rise to worries only recently.

The essential problem of the American economy today depends precisely on the debts, which have acquired very large dimensions. This is the result of a number of economic factors (among which we must include the liberal policy of the central bank) and non-economic factors (among which the military operations in Iraq and the occupation of that country).

During the great depression the problem of debts was considered of primary importance by such great economists as Irving Fisher and Luigi Einaudi. The problem becomes very serious if prices fall, as was then happening, since this forces up the real weight of the debts. Today prices are not falling, but the problem of debts still looms large even if prices are stable.

As early as the beginning of the 1980s Hyman Minsky (1982) had developed a theory of financial instability founded on indebtedness, but today there is very little debate on the problem of debts. As far as I know, six economists have discussed it systematically: the British economist Wynne Godley, the Americans Paul Kugman and James Galbraith and, in Italy, Luigi Pasinetti, Pierluigi Ciocca and myself. Two more Italian economists must be mentioned: Giacomo Vaciago, who discussed the relations between public and private debts in 1993, and Ugo Sacchetti, who analyzed the debt of the families and the foreign debt of the USA in 1999.

In 1934 Luigi Einaudi, then editor of *Riforma sociale* (p. 13), wrote an article for that periodical entitled "Debts" which began with the following sentence: "I am unable to take seriously those who complain or speak of crisis and do not discuss debts". I find this equally true of the times Einaudi lived in and of our own times. Godley has made close examination of the behaviour in America of private debts – families and firms – and foreign debt, notably in an arti-

cle written with Alex Izurieta that appeared in the July 2001 issue of the bullettin of the Levy Economics Institute. Godley's analysis is connected with the study on the subject by Minsky, who has played a fundamental role in the programmes of the Levy Institute.

5. Short term and long term debts

Modern capitalism is based on debts. More precisely, the accumulation process is not even conceivable without debts, since self-financing is on the whole insufficient and cannot apply to all firms. On the other hand firms reaping profits beyond their self-financing needs can provide loans to other firms or banks, which can in turn supply loans mainly by discounting bills, which means creating money. Debts, the irreplaceable instruments of accumulation, are to be repaid or renewed or enlarged. This does not create problems as long as the economy grows; problems arise when the economy stops growing and even regresses. Debts should be repaid in any case; in recession or crisis paying loans and interest becomes a serious problem: an increasing number of firms and families contract new loans only to pay back the old ones. In other words, when the conjuncture is favourable debts are transformed into expenses and thus feed the effective demand for investment and consumer goods, but when the conjuncture is unfavourable debts contracted just to pay those falling due imply a reduction in effective demand, which feeds a negative spiral. *Here lies the source of deflation, today so widely discussed and, under contemporary conditions, taking the form mainly of a reduction in demand, and only to a very limited extent a reduction in prices.*

At this point the distinction becomes relevant between short term and long term debts. As a good example of crisis centring on short term debts we can take a crisis in the stock exchange after a speculative wave: the crisis takes the form of a shortage of liquidity, the amount of which is indicated first of all by the mass of deposits, which depends, on the one hand, on the discounted bills and, on the other hand, on money issued by the central bank. A central bank intelligently governed will supply all the necessary liquidity to stop a possible chain of failures and prevent the financial crisis from turning

into real crisis. Such was the policy adopted in the autumn of 1987 by Alan Greenspan: the financial crisis was overcome in less than three months and it did not degenerate into real crisis. Today's problems are serious because the medium and long term debts have taken on a very great weight. In America families contract long term debts mainly to buy houses, firms to buy new plant and machinery, and to acquire other firms: often such goods or assets are hard to liquidate. By offering their houses as security families can obtain loans from the banks more easily and on better conditions, thus being enabled to buy durable consumers goods that they could not have afforded on their current incomes. In general, in America the growth of family debts has been favoured by liberal credit policies and by the – as we well know, in that country very low – propensity to save.

6. The sustainability of debts

Only recently did I realize that the question of sustainability of private and public debts in the first instance can be discussed in simple terms with the help of an analysis that I developed long ago, back in 1948, in a paper entitled "Saggio dell'interesse e reddito sociale" ("The rate of interest and social income"), presented by Alberto Breglia to the Accademia Nazionale dei Lincei, of which he was a member. In that paper I argued that in modern capitalism the rate of interest is to be seen as a dynamic phenomenon, and that in the long run it tends to coincide with the rate of growth of social income. The basic proposition of my analysis is that the payment of interest does not create difficulties when loans are productive, that is, when their use gives rise to a profit at least equal to the rate of interest, in the case of private loans, or to an increase in social income, in the case of public loans. In turn, with stable prices profit on the social plane implies an increase in income. In both cases the rate of interest tends to correspond to the rate of growth of income. In particular, in the case of public loans the interest does not give rise to problems of income redistribution through taxes, nor does it raise the fiscal pressure if the interest is paid out of the increase in income ensuing upon the use of productive loans, whereas fiscal pressure rises in the case of public loans of an unproductive kind (Sylos Labini 1948, p. 441).

The importance of this point became clear to me when I was invited to present a paper at a meeting organized by the same Academy in April 1998 on the subject "Public debt and financial sustainability". At the same meeting a paper was also presented by Luigi Pasinetti, who had published in the same year, in the *Cambridge Journal of Economics*, an important article on the Maastricht rules, where he defined as sustainable the public debt when the ratio between debt and income (D/Y) diminishes or at least remains stable. In both cases we move in a 'sustainability area'; the final relation that we have to consider is: $S^p/Y - [(i - g)\ D/Y]$, where S^p indicates the primary surplus (public surplus net of interest), i the rate of interest, g the rate of growth of income, D the volume of debt and Y income (I use the expressions 'income', 'social income' and 'gross domestic product' as equivalent). The S^p/Y ratio indicates the capacity of the Treasury to meet, among other things, interest service.

> "It may also be interesting to note", Pasinetti writes in his paper (1998a, p. 108), "how crucial for public finances is the difference between the rate of interest and the rate of growth (both expressed in nominal terms). By considering a limiting case, if such a difference were to be narrowed down to zero, i.e. in the case i = g, [...] it would be possible to maintain constant over time a D/Y ratio of whatever initial amount, merely by observing the constraint of balancing the primary government budget. Interest would indeed be paid with further debt, but the extra debt would be compensated for exactly by the growth of income. Interest payments [...] would not affect the level of fiscal pressure!"

The analogy with the thesis that I was maintaining in my 1948 paper is evident, although Pasinetti had no knowledge of it. In the final analysis, the problems of sustainability of the public debt arise only if the D/Y ratio tends to rise.

In my 1948 paper I was considering mainly the private sector. However, I also wrote (p. 441):

> "As far as public loans are concerned, we observe that if the government uses productively the saving that it gets by selling bonds, those loans contribute to determine the growth of social income and, as a consequence, the taxes that the government imposes to pay interest do not raise the fiscal pressure, i.e. do not push up the ratio between total taxes and the volume of income: in other

words, they create neither obstacles to productive activities nor a reduction in the taxpayers' standard of living".

The fundamental comparison is between the rate of interest and the rate of income growth, and this applies to both private and public loans.

7. Public debt and private debt

The question of sustainability, then, concerns both categories of debts. In its essential terms I had posed the question in my 1948 paper: the question has since been reformulated in original terms by Pasinetti (1998a) and Godley and Izurieta (2001), preceded, in certain respects, by Vaciago (1993) and Sacchetti (1999).

When the rate of interest on public bonds exceeds the rate of income growth for many years, the interest burden becomes crushingly heavy and the problem arises of conversion, free or compulsory, of the public debt. For their part, in recession or crisis, long term private debts often pose the problem of transformation into liquid assets. Normally, we can presume that, as compared with private debt, a higher share of public debt will come from unproductive uses, even if private loans meeting with liquidation difficulties have effects much like those of unproductive public loans.

Vaciago (1993) and, subsequently, Pasinetti (1998a) point out that in various countries the share of one or the other category of debts presents differences appreciably greater than those observed in each country when considering the sum of the two shares. Table 1, taken from Pasinetti's 1998 article (p. 111), illustrates this point; the data show percentage points of GNP and refer to 1994.

The differences between the two shares are to be attributed to policies applied over long periods or else to radical changes in the lines of economic policy, which can, for example, shift from being unfavourable to privatisations to being decidedly favourable.

TABLE 1

DEBTS-GNP RATIO

	Public debt	Private debt	Total
Italy	135	133	268
France	57	321	378
Germany	52	155	207
United Kingdom	59	269	328
Belgium	138	158	296
United States	69	199	268
Japan	88	295	383

I have used Pasinetti's relation to evaluate the sustainability of public debt; more precisely I have examined the behaviour of the difference $S^P/Y - [(i - g)\ D/Y]$. Since all the variables appearing in this relation change, sometimes even considerably, I have examined its behaviour in the course of several years. The strategic variable is *D*, the public debt, which represents the summation of all budget deficit covered by selling bonds. Thus, I decided to follow an itinerary departing from Pasinetti's, which is analysis of comparative dynamics, and calculated the summation of the yearly values of the difference between
S^p/Y and $(i - g)\ D/Y$. If in the course of time the curve increases, this means that S^p/Y is systematically higher than the second term: this rules out problems of the sustainability of the debt; on the other hand, such problems arise if it is the latter term that exceeds the former, i.e. if the curve decreases. It must be pointed out that all variables are expressed in nominal terms: on the one hand this is positive, since it renders the terms of the problem more evident; on the other hand, it means that the previous proposition – that the debt sustainability problems tend to worsen if $(i - g)D/Y$ exceeds S^p/Y – is to be considered only as an approximate indication, strictly speaking applying only if the variations of the rate of interest affect the whole stock of accumulated debt. From diagram A in the Appendix it appears that in America since 1960 problems of public debt sustainability have not arisen: from 1960 to 1978 the curve rose, to oscillate on a quasi stable

level from 1978 up to 1995; since 1995 it has again been rising. It is to be noted that, whereas 2001 saw a budget surplus and 2001 a relatively modest deficit, in 2003 the deficit has jumped to 3.8% as a result of the operations in Iraq, which will aggravate the weight of the public debt.

Is it possible to apply Pasinetti's relation to private debts, and in particular to the debts of families and firms? In principle I think it is, although it is no simple task to find the equivalent of the primary surplus for the private sector. Any solution is affected by a substantial amount of arbitrary judgement. For family debts it might be convenient to use the disposable income net of interest to be paid, and for firms gross profits net of interest. In any case the solution appeared to me clear when I realized that help could come from that very old friend of mine – over half a century old! – namely the difference between the rate of interest (i) and the rate of growth of income (g). Taking account of the primary surplus and the ratios S^p/Y and D/Y means coming closer to reality by considering the ability of the government and private agents to pay interest, but the substance does not change. In fact, if we start from the evident consideration that the D/Y ratio remains stable when D and Y grow at the same speed, then the behaviour of the $i - g$ difference is sufficient to judge the problems of sustainability of debts, be they private or public. In the case of public debt I was able to use both Pasinetti's relation and the $i - g$ difference; here, too, I used the summation of the yearly values of that difference. As expected, the curve mirrors the curve obtained from Pasinetti's relation (see Figures A and B in the Appendix). This is important, since in this way we are authorized to use the simple $i - g$ difference without the trouble of finding or estimating the other data. At this point we may recall that the interest paid on public bonds, given the length, is less than the interest banks charge on loans to private firms, even if we consider only loan charges to the best customers ('prime rate'). The reason, as we well know, is that in the case of private loans the risks are higher than in the case of public loans. However there is another, deeper reason, not immediately clear but important, since it has to do with the sustainability of debts. Governments resort to various devices to keep as low as possible not only the interest on public bonds but also the main bank interest governing all the others, or in other words the 'official' discount rate. This behaviour is rational, not only because it aims at reducing burdens for the budget

but also because in this way the government avoids or softens the problems arising for debt sustainability in the long run. Moreover, the $i - g$ difference leads us to reflect on the Keynesian liquidity trap: my analysis reaches out from the – certainly relevant – monetary area to enter the real area, since it involves the behaviour of income. In fact, to avoid problems of debt sustainability a zero variation in income would, strictly speaking, require zero interest, whereas a diminution of income would require negative interest.

The sustainability of debts is to be judged not in isolation, but by considering together the private debts of families and of firms, and these together with the public debts. It is expedient to examine the behaviour of the ratios between the two kinds of debts and income, and to sound the alarm when this behaviour shows an increase over a long period.

The problem of debts and of their sustainability is to be judged not only from the standpoint of stocks but also from that of flows: Wynne Godley and Alex Izurieta illustrate well this thesis in their 2001 paper. In a recent letter Wynne Godley has pointed out to me that in the *Bulletin* of the Federal Reserve System "Flows of Funds – Accounts of the United States" for September 2003 in America "the rise in net lending (corrected for inflation) relative to income was at an all time record. So the rise in the debt/income ratio has actually accelerated".

8. Collateral observations

The following four observations complement my previous analysis.

The first observation concerns the American foreign debt, which is the result of the accumulation of deficits in the balance of payments over the years (see the data in the Appendix). Until recently such deficits had been offset by the inflow of foreign capital, but the inflow is no longer regular, and often falling, as the euro/dollar exchange rate shows – in a few months it has risen from about 85 cents to 1.10 dollars. Apart from some modest advantage in terms of slowing down inflation, the European countries have no reason to be smug about this since their exports to America are steadily losing

competitiveness, as can already be clearly seen. The central bank can affect the behaviour of exchange rates through monetary policy, whereas the Treasury, in agreement with the central bank, can also affect that behaviour either by manoeuvring reserves or through international agreements, like the Plaza Hotel agreement in the 1980s.

The second observation concerns Luigi Einaudi. In his 1934 article Einaudi approvingly cites Maffeo Pantaleoni on the bankruptcy of Credito Mobiliare, where he addresses the problem of the illiquidity of long term debts and eventually expresses, despite his convictions as a free-trader – albeit not a dogmatic one – a favourable judgement on the public rescuing of large firms or banks, and goes on to laud the creation of IMI and IRI.

The third observation concerns Japan. In that country it has been clear for years that the central problem was given by long term debts weighing, in the first place, on the banking system. For Japan in the Appendix, Figures D and E present two curves expressing the summation of the yearly differences between the rate of interest and the rate of growth for both the private and the public debt: the behaviour of the two curves fully corresponds to expectations emerging from the analysis conducted here. It seems clear that the public debt had not been a problem; only since 1997 has it begun to give rise to some worries, although the rate of interest on public bonds has fallen close to zero. On the other hand, for several years the sustainability of private debts has clearly been decreasing. In Japan the problem that summarizes the others is the problem of illiquidity of the long term debts of families, banks and firms. I learn from *The Economist* (April 19 and May 24, 2003) that, after many uncertainties and prolonged studies, the Japanese government has started a sort of nationalization of a large bank (Resona) and promoted the creation of a public body to take care of long term debts particularly difficult to liquidate; its name is "Industrial Revitalization Corporation", and it seems almost a replica of IMI or IRI. Roosevelt's America also addressed the problem of illiquidity of long term debts with public intervention. I do not know whether today's free-traders have mulled over these cases, but I believe it would be worthwhile to study them and see whether some useful ideas could be drawn for the present problems. The central problem is to find a rational system to make the burden of the long term debts of the banks and struggling large firms bearable. Considering that public debts are less costly than private debts – fewer risks

and less interest –, it is worth examining the expediency of transforming private into public debts and under what conditions.

The fourth observation concerns America. By now the reasons are clear why the serious problems facing the American economy are largely independent of the attack on the Twin Towers and the Iraq war. The war itself was short, but it has been followed by guerrilla action leading to a fall in oil production in that region, with an increase, albeit limited, in the price of oil. President Bush junior has to face two problems: loss of credibility for having given false information on Saddam Hussein's weapons of mass destruction and the economic crisis. These are two serious problems raising doubts about his political survival. Here I have discussed the problem of the economic crisis. Let us remember that Bush senior was brought down by recession far less serious than the present crisis. If America's internal problems become serious, the government will be compelled to concentrate its efforts on them and put aside its plans for imperialistic expansion – a prospect that I, like many American intellectuals, consider positive for all.

In economics accurate forecasts are not possible; we can only make hypothetical previsions based on detailed diagnoses. Often the discussion contemplates alternative scenarios and as a rule two scenarios are envisaged, one labelled 'pessimistic', the other 'optimistic'. I am inclined towards the 'pessimistic' scenario. I may be wrong, but responsible persons cannot contradict me with simple assertions to the effect that the optimistic view is more likely to be true; they have to show why I am wrong and propose another diagnosis. The question is too important to be settled with declarations of confidence in the recovery capacity of American capitalism, averring, like Hoover, that "prosperity is around the corner".

9. Conclusions

At present (September 2003) certain positive signals can be seen in the American economy. In the past few months the stock exchange, and in particular the shares of the firms in the new technologies, have gone up, while GDP is increasing at a yearly rate of 2%. And yet, the hypothesis must be considered that the recovery in the stock ex-

change depends on the tax cuts on dividends introduced by Bush, and that the increase in GDP depends on deficit spending and an extraordinarily liberal credit policy, which has affected total consumption but very little investment of the firms. Employment, too, has failed to show signs of recovery. Various economists have pointed out that several important corporations have shifted abroad some of their productive operations to profit from the much lower levels of wages and salaries, especially in India and China. This is true, but in the preceding years of prosperity (1991-2000) this process was already under way and yet employment had risen by 17 million persons, whereas in the last three years there has been a fall of about two and a half million. No: the reasons for this fall and the increase in unemployment (from about 3.5 up to 6.2%) is the decline in investment of the firms, which decreased by several points from 2000 to 2002 and has continued to decrease even in the first half of this year, from 9.7% of GDP in 2000 to 8.5% (data kindly supplied by the Research Department of the Bank of Italy). In my opinion, an important reason for this decrease is the reduced propensity of firms to run into debt owing to the heavy burden of already existing debts. However, we have to recall that the level of investment by firms in the second quarter of 2003 has increased by 8%; but in the preceding five quarters it underwent violent and apparently inexplicable oscillations: –5.8, –2.4, –0.8, +2.3, –4.4%. Thus, we must be cautious in drawing conclusions: it is possible that a genuine recovery is under way, but we certainly cannot exclude the possibility that the recovery is ephemeral because doped.

Some of the above data refer to the share of the investment of the firms on income, others to the level of investment. Accepting a suggestion by Stefano Sylos Labini, I have recognized that, in comparing the behaviour of investment with that of employment, it is preferable to use the share on income rather than the level. The fact is that investment has two effects, one on productivity, another on productive capacity and on employment: one or the other effect tends to prevail according to the type of investment. To recoup profits, managers give priority to investment stimulating productivity in the first place: only when expected demand is increasing at a sustained rate will investment increase more than income, and we will have an increase in both productivity and employment. It is possible that investment may not be much higher than depreciation funds, which can be sufficient to substitute old machinery with new, saving labour yet

more than the former; such funds, being largely obtained through current receipts, avoid problems of indebtedness. Today the paradox is much debated of a productivity that in America is increasing while the share in income of the investment of the firms is fluctuating on a relatively low level and unemployment has reached a pathological level without showing signs of diminution. It is not a paradox, as the previous observations can make clear. After all, a similar behaviour occured during the great depression of the 1930s, as I recalled several years ago (Sylos Labini 1964, pp. 168-72) and as Colin Clark (1937, p. 272) had pointed out: the substitution investment, largely financed with depreciation funds was pushing up productivity, even with a persistently high unemployment (the data can be found in the two volumes *Historical Statistics of the United States – Colonial Times to 1970*, Washington 1975, pp. 162, 195 and 265). This, too, is an analogy with the great depression. If we examine the same variables in the Nineties in Japan, we notice similar behaviour: share of investment of the firms on income first in diminution then oscillating on a stationary level, sustained increase of productivity, share of unemployment pathological high.

At least for the time being, then, I confirm my diagnosis: this crisis is very serious. The central problem, in my opinion, lies in the long term debts. I do not believe it is worth reviving the IRI formula as Japan seems to be set on doing. Thoughts should probably be turning to other solutions to reduce the debt burden and favour full recovery. Important results could be obtained through an agreement among the main industrialized countries to stimulate the reciprocal expansion of markets. What I have in mind here is a coordinated series of commercial treaties dovetailed together to promote a policy opposed to the so-called 'beggar-my-neighbour-policy' adopted by the industrialized countries in the 1930s and recently fished up again by Bush with his protectionist measures. To escape from the crisis he is also looking to measures of a Keynesian type with a sharp increase in deficit spending and tax cuts. While the Bush plan to reduce dividend taxation has positive effects first of all on the Stock Exchange, the policy of tax cuts to the benefit of the rich does not seem to me particularly valid, nor does the Keynesian recipe since selling bonds to finance the deficit could push up the rate of interest with negative consequences on investment by firms, on the purchase of durable goods

by consumers – houses in the first place – and more generally on the payment of interest on debts in the private sector.

The American crisis is, then, to be taken very seriously, as indeed an increasing number of economists are now tending to do. The diagnoses offered, however, seem superficial, as do the recommended policy measures – a new reduction in the interest rate, as well as tax cuts and deficit spending.

The American crisis is putting a brake on economic growth and employment in the countries of Europe, and is creating problems in their public finances and in certain large European firms. All the countries of the Union are experiencing difficulties, and Italy more than the others since the government has adopted a very dubious economic policy including one-off fiscal measures. We are particularly hit by the devaluation of the dollar since our exports consist mainly of traditional products, vulnerable to price competition: moreover, the range of new products is very limited, since the efforts made by the state and industrialists in research have long been all too feeble, especially in the last few years. Only in a few sectors of the mechanical industry do we find adequate innovative investments. For the traditional industries the most dangerous competition comes from the countries that have recently started a process of industrialization since they are able to implement new standardized technologies and have wages that are a fraction of ours. The defence against such a competition lies not in customs protection, but in the creation of new products, or of new types of old products (Sylos Labini 2000, pp. 103-04).

The crisis of the American economy has strong repercussions not only on Europe but on the whole world; the – already serious – difficulties of other important countries like Japan and Argentina have become even graver as a result of the American crisis. The Third World countries show markedly differentiated behaviours: in the markets that saw America's presence weakened due to its crisis these countries are growing even more than in the past, thanks especially to export of the goods of the traditional industries: to produce these goods they use technologies requiring a low degree of mechanization and a high degree of direct labour, which allows for considerable flexibility of prices. This means greater competitiveness in the international markets, especially during recessions. Given this stimulus a number of Third World countries are setting up increasing pressure for the industrialized countries to phase out the obstacles of various

kinds raised to protect their agriculture; the way out, however, is not this one: it is the way of organizational aids.

Actually, the Third World countries present a sharply differentiated picture: some, like the two giants, China and India, show remarkable dynamism, while others are grappling with difficulties even more serious than in the past; such is the case of the hungry countries, above all in sub-Saharan Africa.

A vigorous programme of aid, preceded by the 'consultation' of economists of various countries and promoted by the major industrialized countries could, with its collateral effects, also prove advantageous for the volume and quality of employment of the highly industrialized countries. These countries should, however, offer their aid not in terms of financial transfer, but in terms of technical and organizational assistance in the fundamental areas of economic and social development, namely education, health and the introduction of new productive techniques. In countries like those of sub-Saharan Africa this in turn presupposes reform of the village communities. To be sure, large infrastructures are also necessary but, to avoid corruption and waste, they should be implemented by the United Nations or the European Union.

A policy of aid to the hungry countries should follow upon the launch of a policy specifically designed to address the economic crisis of the industrialized countries. Such proposals, however, which should have at least the support of the American government, appear unattainable given the political position of the present government. For the immediate future the picture does not look too promising, but we have to make an effort to look farther.

The right economic and political strategy, carried out through agreements between America and the European Union, would be capable of averting the depressing prospect envisaged by John Maynard Keynes in his *General Theory* when he observed (1936, p. 249):

> "it is an outstanding characteristic of the economic system in which we live that [...] it seems capable of remaining in a chronic condition of sub-normal activity for a considerable period without any marked tendency either towards recovery or towards complete collapse".

In the times of the great depression of the 1930s the level of activity remained below the norm for years – unemployment exploded

after 1929, reached the level of 25% in 1932, and in 1939 still exceeded 15%; it was only with the war that it practically disappeared. At the present moment – September 2003 – it stands at 6.2%, a pathologically high level. The prospects are dark, although not so dark as in the 1930s, thanks to the very low probability of a sharp price fall; however the risk is not to be ignored of a relevant fall in the prices in the real estate markets. Even if the serious mistakes in monetary policy committed in 1929 and the following years can be excluded and a fall in output does take place, a situation of quasi stagnation implies very serious problems, since zero income growth does not necessarily mean zero productivity growth and, if productivity increases while income stands still, employment goes down.

The squalor of the economic prospects is accompanied by squalor in our civil life. I think that we have to react by adopting a strategy in two, partly overlapping stages, like the one sketched out above, addressing the economic crisis of the industrialized countries and then aid to the hungry countries. In the second stage this strategy would imply the engagement of many people in remunerated and voluntary activities, and would offer ideals worth pursuing for the new generations in the place of the obsessive pursuit of money dominating and impoverishing social life in the advanced countries today: young people have, as it were, a biological need of ideals.

APPENDIX

Data on the sustainability of debts

TABLE A

SUSTAINABILITY OF DEBTS, UNITED STATES
(Values in nominal terms)

Anni t	Figure A Public debt		Figure B Public debt		Figure C Private debt		Foreign debt
	(a)	(b)	(c)	(d)	(e)	(f)	
	x	Σx_j (t, j = 1960)	$y = i_{pu} - g$	Σy_j (t, j = 1960)	$z = i_{pr} - g$	Σz_j (t, j = 1960)	
1960	4.22	4.22	–1.0	–1.0	0.9	–0.9	
1	3.43	7.65	–1.1	–2.1	1.0	0.1	
2	3.34	10.99	–4.7	–6.8	–3.0	–3.1	
3	4.53	15.52	–2.3	–9.1	–1.0	–4.1	
4	4.56	20.08	–3.9	–13.0	–2.9	–7.0	
5	4.98	25.06	–4.4	–17.4	–3.9	–10.9	
6	4.99	30.05	–4.7	–22.1	–4.0	–14.9	
7	1.90	31.95	–1.4	–23.5	–0.1	–15.0	
8	3.91	35.86	–4.0	–27.5	–3.0	–18.0	
9	2.97	38.83	–1.4	–28.9	–0.1	–18.1	
1970	0.55	39.38	0.9	–28.0	2.4	–15.7	
1	0.97	40.35	–3.3	–31.3	–2.9	–18.6	
2	3.07	43.42	–5.8	–37.1	–4.6	–23.2	
3	2.91	46.33	–4.7	–41.8	–3.7	–26.9	
4	2.08	48.41	–0.4	–42.2	2.5	–24.4	
5	3.69	52.21	–3.1	–45.3	–1.0	–25.4	
6	1.59	54.80	–6.5	–51.8	–4.7	–30.1	
7	2.40	57.20	–6.1	–57.9	–4.6	–34.7	
8	3.43	60.63	–5.8	–63.7	–3.9	–38.6	
9	2.47	63.10	–1.8	–65.5	0.9	–37.7	
1980	–0.57	62.53	2.6	–62.9	6.4	–31.3	366
1	0.21	62.74	2.0	–60.9	6.9	–24.4	356
2	–3.80	58.94	6.6	–54.3	10.8	–13.6	236
3	–2.07	56.87	0.1	–54.2	2.3	–11.3	257
4	0.10	56.97	–1.7	–55.9	1.7	–9.6	134
5	–0.62	56.35	0.4	–55.5	2.8	–6.8	97
6	–0.73	55.62	0.3	–55.2	2.6	–4.2	101
7	0.80	56.42	–0.7	–55.9	1.7	–2.5	51
8	1.42	57.84	–1.0	–56.9	1.6	–0.9	15
9	1.09	58.93	0.6	–56.3	3.4	2.5	47

TABLE A *(cont.)*

Anni t	Figure A Public debt		Figure B Public debt		Figure C Private debt		Foreign debt
	(a)	(b)	(c)	(d)	(e)	(f)	
	x	Σx_j (t, j = 1960)	$y = i_{pu} - g$	Σy_j (t, j = 1960)	$z = i_{pr} - g$	Σz_j (t, j = 1960)	
1990	–0.41	58.52	1.8	–54.5	4.3	7.8	164
1	–1.34	57.18	2.2	–52.3	5.3	13.1	261
2	0.20	57.38	–2.1	–54.4	0.7	13.8	452
3	0.83	58.21	–2.1	–56.5	0.9	14.7	144
4	1.85	60.06	–1.9	–58.4	1.0	15.7	124
5	0.84	60.90	0.6	–59.0	3.9	19.6	343
6	2.47	63.37	–0.6	–58.4	2.7	22.3	387
7	2.69	66.06	–0.6	–59	1.9	24.2	835
8	3.70	69.76	–0.8	–59.8	2.7	26.9	1094
9	3.94	73.70	–0.9	–60.7	2.4	29.3	1054
2000	4.99	78.69	0	–60.7	3.3	32.6	1583
1	2.24	80.93	0.9	–59.8	4.3	36.6	2302
2	6.18	87.11	–3.1	–62.9	0	36.6	2309

Source: Elaborations on data kindly supplied by the Research Department of the Bank of Italy.

Legenda:

t = anno

$$x = \left[\frac{S^p}{Y} - (i_{pu} - g) \frac{D_{pu}}{Y} \right]$$

$y = i_{pu} - g$

$z = i_{pr} - g$

S^p = primary surplus

Y = income (GDP)

i_{pu} = rate of interest on public bonds

g = rate of growth of income

D_{pu} = public debt

i_{pr} = bank rate of interest (prime rate).

TABLE B

SUSTAINABILITY OF DEBTS, JAPAN, 1981-2002
(Values in nominal terms)

Years	Figure D Public debt		Figure E Private debt	
t	(g) a	(h) Σa_j (j = 1981 to t)	(i) b	(l) Σb_j (j = 1981 to t)
1981	–1,48	1,48	0,8	0,8
2	0,22	1,26	2,3	3,1
3	1,00	0,26	2,5	5,6
4	–1,89	2,15	–0,2	5,4
5	–2,09	4,24	–0,5	4,9
6	–1,04	5,28	0,9	5,8
7	–2,13	7,41	0,3	6,1
8	–4,92	12,33	–2,4	3,7
9	–4,47	16,80	–1,6	2,1
1990	–2,76	19,56	–0,1	2,0
1	–0,80	20,36	0,8	2,8
2	0,83	19,53	2,8	5,6
3	1,10	18,43	3,3	8,9
4	0,63	17,80	3,0	11,9
5	–0,34	18,14	1,6	13,5
6	–2,53	20,67	–0,4	13,1
7	–2,03	22,70	0	13,1
8	1,41	21,29	3,4	16,5
9	0,79	20,50	2,8	19,3
2000	0,33	20,17	2,2	21,5
1	0,87	19,30	2,8	24,3
2	1,01	18,29	2,5	26,8

Source: "Main economic indicators of Japan", Ministry of Finance, Tokyo, August 2002.

Legenda:

t = year
$y = i_{pu} - g$
$z = i_{pr} - g$
S^p = primary surplus
Y = income (GDP)
i_{pu} = rate of interest on public bonds
g = rate of growth of income
D_{pu} = public debt
i_{pr} = bank rate of interest (prime rate).

FIGURE A

UNITED STATES – PUBLIC DEBT (SECOND CRITERION)
(Table A, column b)

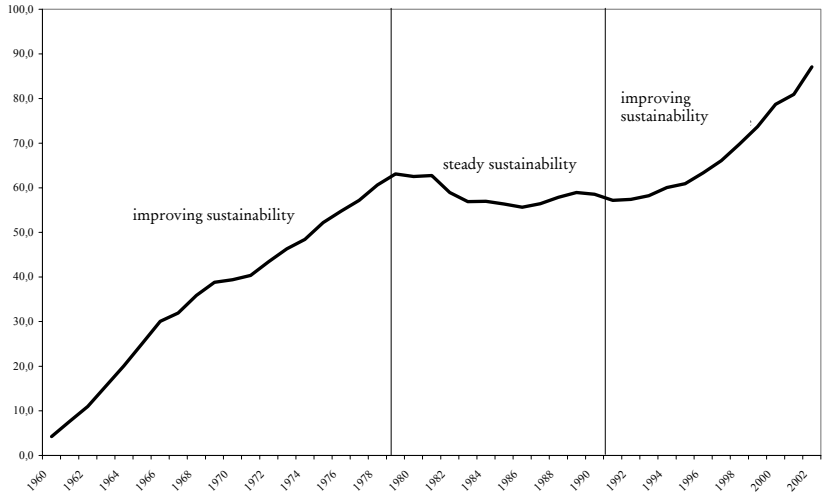


FIGURE B

UNITED STATES – PUBLIC DEBT (FIRST CRITERION)
(Table A, column d)

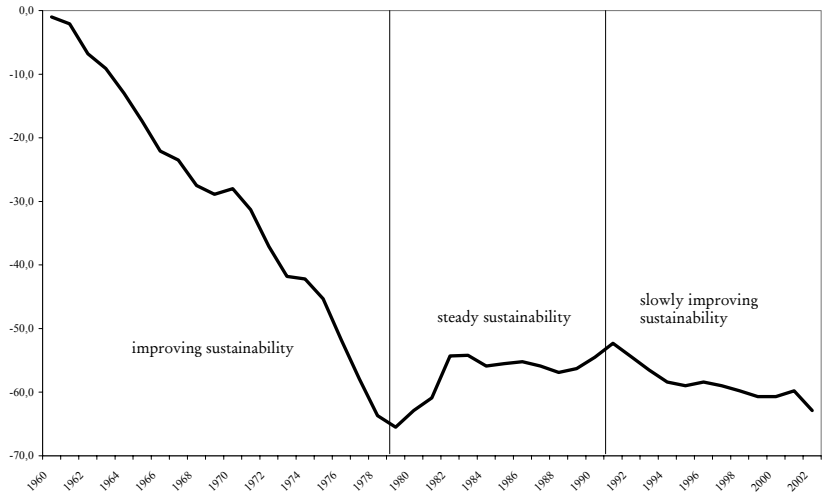


FIGURE C

UNITED STATES – PRIVATE DEBT
(Table A, column f)

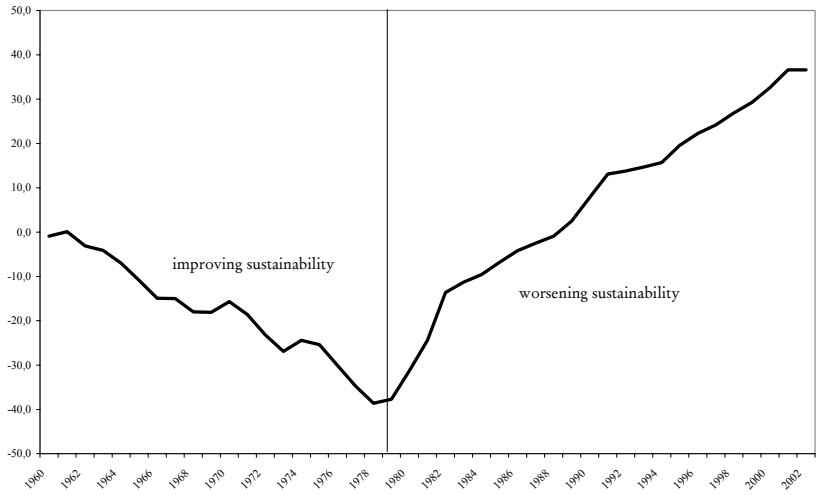
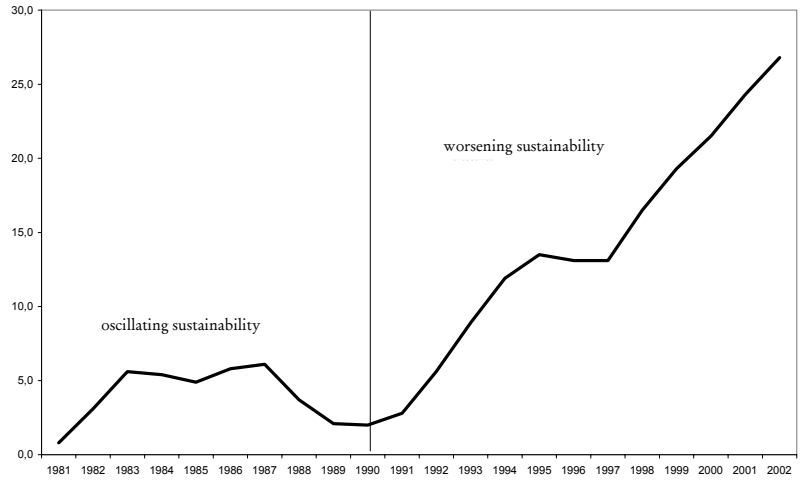


FIGURE D

JAPAN – PUBLIC DEBT
(Table B, colum h)

FIGURE E

JAPAN – PRIVATE DEBT
(Table B, column l)



Crisis in various large American firms of an oligopolistic nature

In America over the last few years a number of large firms have experienced serious difficulties due to both the economic crisis and abuse by top managers, allotting themselves high compensations, also in the form of shares: losses in the budget were hidden thanks to the complicity of consulting companies. This the list of the top ten corporations entering crisis: the list is the result of an informal survey prepared by the New York delegation of the Bank of Italy. For each corporation the fields of activity are mentioned as well as the value of assets as of 31st of December 2001, in billions of dollars; naturally since then things have changed.

1. AOL Time Warner Internet Entertainment (160).
2. Worldcom, Integrated Telephony (104)
3. Qwest Integrated Telephony (74)
4. Enron, oil pipelines, energy (63)
5. Tyco, Electromechanics, optic fibers (57)

6. Xeros, business equipment (28)
7. Global Crossing, Telecommunications (26)
8. Adelphia Communications, Cable Television (24)
9. AON, Insurance Brokerage (23)
10. Kmart, Retail Sales (17).

The total assets of the above corporations amount to about half a billion dollars: a stunning figure!

REFERENCES

CLARK, C. (1937), *National Income and Outlay*, Macmillian, London.

EINAUDI, L. (1934), "Debiti", *La Riforma Sociale*, vol. XLV, pp. 13-27.

FISHER, I. (1933), "The debt-deflation theory of great depressions", *Econometrica*, vol. 1, October, pp. 337-57.

GALBRAITH, J. (2001), "The meaning of a war economy", *Challenge*, November-December, pp. 5-12.

GODLEY, W. and A. IZURIETA (2001), "As the implosion begins ...? Prospects and policies for the U.S. economy: a strategic view", Jerome Levy Economics Institute, July.

KEYNES, J.M. (1936), *The General Theory of Employment, Interest and Money*, Macmillan, London.

MARX, K. (1977), *Capital*, 3 vols, reprint, Progress Publishers, Moscow.

MINSKY, H. (1982), *Can 'It' Happen Again? Essays on Instability and Finance*, Sharpe, Armonk.

PANTALEONI, M. (1910), "La caduta della Società Generale di Credito Mobiliare Italiano", in *Scritti varii di economia*, vol. 3, Laterza, Bari, pp. 323-615.

PASINETTI, L.L. (1998a), "The myth (or folly) of the 3% deficit/GDP Maastricht 'parameter'", *Cambridge Journal of Economics*, vol. 22, pp. 103-16.

PASINETTI, L.L. (1998b), "L'anomalia del debito pubblico italiano: due modi per affrontarla", in *Rendiconti dell'Accademia Nazionale dei Lincei*, Roma, Classe di Scienze Morali, serie IX, vol. 9, n. 4, pp. 509-25.

SACCHETTI, U. (1999), "Whither the US economy?", *Banca Nazionale del Lavoro Quarterly Review*, March, pp. 69-94.

SCHUMPETER, J.A. (1939), *Business Cycles – A Theoretical, Historical, and Statistical Analysis of the Capitalist Process*, McGraw Hill, New York.

SYLOS LABINI, P. (1948), "Saggio dell'interesse e reddito sociale", *Rendiconti dell'Accademia Nazionale dei Lincei*, Classe di Scienze Morali, serie VIII, vol. 3, fasc. 11-2, novembre, pp. 426-53.

SYLOS LABINI, P. (1964), *Oligopoly and Technical Progress*, Harvard University Press, Cambridge, Mass. (original Italian edition 1956).

SYLOS LABINI, P. (1982), "Rigid prices, flexible prices and inflation", *Banca Nazionale del Lavoro Quarterly Review*, March, pp. 37-68.

SYLOS LABINI, P. (1984), *The Forces of Economic Growth and Decline*, The MIT Press, Cambridge, Mass.

SYLOS LABINI, P. (1998), "Sviluppo economico, interesse e debito pubblico", *Rendiconti dell'Accademia Nazionale dei Lincei*, Classe di Scienze Morali, serie IX, vol. 9, fasc. 3, aprile, pp. 533-44.

SYLOS LABINI, P. (2000), *Underdevelopment – A Strategy for Reform*, Cambridge University Press, Cambridge.

SYLOS LABINI, P. (2002), "Le prospettive economiche fra ripresa e recessione", *Il Ponte*, maggio, pp. 81-91.

VACIAGO G. (1993), "Debito pubblico *versus* debito privato", *Moneta e Credito*, settembre, pp. 331-47.