Reforms or the bailiffs?

James Tobin, winner of the Nobel Prize for economics, was particularly right to emphasize what he called “liquidity constraints”. Households may find themselves in situations where they have to meet major financial deadlines, in the short and even very short term. They will often behave in a relatively irrational way in order to try and satisfy their creditor(s) and avoid any kind of penalty that could be imposed on them, whether contractual, financial, legal or reputational. For example they will sell shares at a loss purely to gain some cash, refinance loans under usurious conditions, rush to “aunty” to put the family jewels in hock, risk everything on transactions that they would never have touched had they not already heard the bailiff’s footsteps on the stairs.

When liquidity constraints begin to tighten and financial deadlines get closer, the economic horizon shrinks and we become short sighted, stressed, and obsessed by the growing obstacle before us that seems insurmountable. This is how people become prey to loan sharks, living from hand to mouth, endlessly searching for expedients, taking ill-considered risks, and so on. They start dreaming of miracles. As the English put it so well: “they start to bet on the second coming”!

Let’s be frank: economic rationality is an increasing function of financial flexibility, which is itself a decreasing function of liquidity constraints. It is, moreover, no coincidence that the rating agencies consider financial flexibility as one of the key criteria to take into consideration when assessing the financial strength of a company or a State. Yes, rationality needs a great many degrees of freedom to operate!

These situations where debtors get into “panic” mode can have serious consequences, which is why systems have been created – in various different forms – to avoid such consequences and enable households or companies to some extent to recover their wits, in the true sense of the term. For households, various procedures are in place in several countries to deal with over indebtedness, extending to the “personal recovery” of the 2003 Borloo law in France or personal bankruptcy in the United States. For companies, there are agreed facilities that always equate to a form of temporary suspension of prosecution, such as the famous “Chapter 11” in force across the Atlantic. During this period debtors are given time to find solutions to their financial problems, such as the sale of assets, recapitalisation, debt consolidation and debt restructuring, accompanied in some cases by debt waiver. We are entering, then, into an era of conditionality where economic agents are placed on credit watch. It is striking to note that what applies to individuals and companies, also exists for States, with the fundamental difference that State goods cannot be seized. However, when a State cannot meet its financial deadlines, it finds itself in the hands of international organisations, notably the IMF, which sanctions countries in the same way that the commercial courts sanction companies!

The situation with regard to public finances is such that, because we have not managed our budget with an eye on the long term, and because we have let deficits persist and debts accumulate, we are seeing deadlines coming closer. And the inevitable rise of interest rates could well speed things up… We note, moreover, a sudden desire to – partially – bridge deficits, through a whole series of fiscal and social measures that trickle away into nothing from one day to the next, with a general consistency that is not, a priori, obvious. Time is certainly pressing, but we should take care not to multiply short-term fiscal and social expedients that will do nothing to resolve the fundamental challenges faced by our country.
Loosening liquidity restraints through short-term expedients will not really help to ensure the long-term solvency of our public and social system in an open world. And those who currently stand against the (highly reasonable) reform of pensions through distribution – after having happily created public and social deficits – have been struck by irresponsible blindness and are displaying a guilty kind of irrationality. They should not be surprised if they hear footsteps on the stairs one day…

Only a long-term, rational plan involving fundamental and ambitious reforms to reconcile our liabilities, will distance and then eliminate the deadlines that are obscuring our future, and avoid the possibility of supervision or even default, which would be dreadful and totally unacceptable.

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