

How to get out of the debt trap?

Navigating the global financial turmoil

Global economies faced a precarious cycle of recovery pre-pandemic, marked by currency imbalances and interest rate cuts, resulting in a staggering 300 trillion USD global debt burden. Urgent reform of the international monetary system is necessary to address escalating geopolitical crises and economic vulnerabilities, requiring coordinated efforts and a shift towards inclusive and resilient frameworks. Renowned French experts Jean-François Serval, president of Groupe Audit Serval & Associés, and Jean-Pascal Tranié, founder and president of Aloe Private Equity, propose transforming stagnant financial reserves into wealth by converting a sizeable portion of public debt into productive assets within the real economy.

Amidst the backdrop of financial tumult, preceding both the COVID-19 pandemic and the Russia-Ukraine war, global economies experienced a precarious cycle of recovery. However, this resurgence, culminating in 2018, relied heavily on currency imbalances and interest rate cuts, fostering a colossal global debt burden. This debt – now nearing 300 trillion USD including over 100 trillion in public debt, or almost 120% of global

GDP – presents a formidable challenge due to its complexity and escalating magnitude. The disparity between this debt and the stagnant GDP in Western countries underscores a systemic distortion, fostering distrust in the monetary system and fuelling volatility in financial markets.

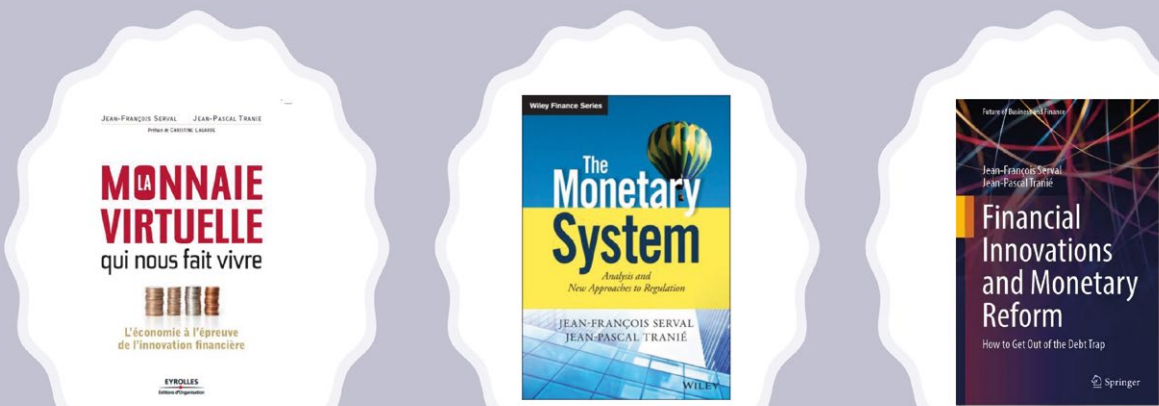
The root of this systemic malaise can be traced back to the post-World War II era, characterised by the dominance of the

US dollar and from the 1980s onwards, after three decades of strong growth, subsequent lack of rapid inflation to offset nominal debts. As economic actors increasingly decouple monetary volumes from currency, the debt spiral intensifies, facilitated by artificially low interest rates and state guarantees. This relentless debt expansion, exacerbated by a revolution in payment methods, poses an existential threat to the global economy.

In response to the escalating geopolitical crisis and mounting economic vulnerabilities, urgent reform of the international monetary system is imperative. The onset of conflict amplifies inflationary pressures and increases public debt burdens, necessitating a coordinated effort to redefine global economic governance.

Despite escalating tensions and geopolitical rivalries, a negotiated transition to a more inclusive and resilient monetary framework is not only feasible but essential for global stability. Europe, as a significant economic player, stands poised to facilitate dialogue and cooperation between competing powers, underscoring the need for a multipolar monetary conference to recalibrate the global economic order.

The book *Financial Innovations and Monetary Reform: How to Get Out of the Debt Trap* offers a groundbreaking perspective on global monetary reform. Authored by renowned French experts Jean-François Serval, president of Groupe Audit Serval & Associés, and Jean-Pascal Tranié, founder and president of Aloe Private Equity, a regulated fund management company, the daring vision presented advocates



The books *La Monnaie virtuelle qui nous fait vivre: L'économie à l'épreuve de l'innovation financière* (2009), *The monetary system: Analysis and new approaches to regulation* (2014), and *Financial innovations and monetary reform: How to get out of the debt trap* (2023) by Serval and Tranié provide a detailed analysis of the current debt crisis and the proposal to overcome it.

for the conversion of public debt into equity in productive businesses, fostering innovation and economic growth.

With a focus on technical feasibility, the authors aim to galvanise support for their bold approach which aligns with ongoing efforts to invest in vital infrastructure and pioneering research projects worldwide – projects that are profitable because they help develop trade. As proponents of a new era in economic policy, their work underscores the urgent need for innovative solutions to navigate the complexities of global debt.

RESTRUCTURING PUBLIC DEBT: THE CORE OF MONETARY REFORM

The authors propose that, to navigate the current economic imbalance, characterised by skewed risk-reward dynamics and, until recently, effectively negative rates, a fundamental shift is imperative. This entails reducing public debt to restore a market-driven system of capital remuneration, devoid of state intervention. By aligning bond and share dividends with market risk appreciation, governments can facilitate a significant reduction in the public debt burden.

However, addressing this challenge requires careful consideration of potential avenues for debt adjustment. Options range from central banks raising long-term rates to promote debt repayment, to exploring debt conversion into non-repayable equity instruments, as proposed by the

authors. Each approach carries distinct implications for economic stability and market dynamics, underscoring the complexity of the task at hand.

ROCKING THE BOAT: STIRRING UP VALUE REDUCTION WITH RATE HIKES

Serval and Tranié highlight that before the pandemic, central banks contemplated elevating interest rates to counter the rising tide of public debt – a move that would ripple through

within the eurozone. However, recent announcements signal a shift in policy, with the ECB opting to cease securities purchases and initiate rate hikes, signalling a growing consensus on the need for debt reduction and macroeconomic stability.

THE DEBT DILEMMA

Debts, often viewed one-dimensionally, represent only the flip side of claims within interconnected economic entities. While they optimise cash flow and

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financial markets. Investors wary of government debt sought refuge in tangible assets like real estate and corporate securities, diminishing the appeal of purely financial securities. However, a rate hike would precipitate a market downturn, prompting a mass exodus of investors.

Governments have been reluctant to raise rates, fearing repercussions on investment and consumption. While the Federal Reserve initiated rate hikes, the European Central Bank's (ECB) cautious approach underscores the diverse economic landscape

facilitate market debt, debts themselves don't alter economic realities. Through a process of offsetting balances within a group of interconnected companies, debts can decrease without impacting the real economy.

This process, typical in financial and industrial groups, offers clarity on debt amounts without altering economic exchanges. However, it doesn't affect individual debts to companies or total public debt. While it highlights quantity of debts, this method doesn't address the structural necessity of reducing debt as a critical facet of monetary reform.





The authors believe that the path to reducing public debt lies in converting it into equity, tailored to the unique circumstances of each currency zone.

EXPLORING EQUITY

The authors propose that the path to reducing public debt lies in converting it into equity, tailored to the unique circumstances of each currency zone. Governments and monetary authorities, as last resorts, must address false money that has been issued to avoid default, which would harm all savers and pensioners. Most debt holders, primarily financial institutions, find these debts difficult to access before maturity.

A zone-by-zone debt reduction strategy, utilising funds financed by central bank

stabilise debt reduction and increase interest rates gradually.

DEBT REDUCTION

The authors' approach to addressing overwhelming debt isn't about simply brushing it off or staggering payments indefinitely. Instead, they aim to breathe life into deflationary financial masses by transforming them into tangible wealth creation. To achieve this, they propose a substantial portion of public debt be converted into equity within companies, fostering new profitable investment ventures. This involves exchanging low

systems transitioning to funded models. Three major economic zones can be identified: the eurozone, the dollar zone, and Asia, which can be divided into two main zones: the Chinese world and its periphery, which includes Japan and Korea, and India.

To prevent disruption, equity instruments replacing debt may lack voting rights, unless companies seek to internationalise with the arrival of new shareholders. A debt-for-equity swap, restoring confidence in balance sheets, promises economic growth, bolstering stock markets and facilitating a more balanced interest rate scale for investments. Gradual implementation, controlled by international agreements, is crucial to avoid destabilising money supplies.

FORGING A NEW FINANCIAL FRONTIER

The world is grappling with excessive money supply and a lack of international financial regulation, leading to soaring public debt. Serval and Tranié's proposal aims to transform this debt into tangible wealth creation, rather than perpetually deferring payments. Converting public debt into equity in companies and investing in profitable projects will help alleviate the burden of debt while stimulating economic growth.

However, this approach requires coordinated action within major economic zones and careful consideration of international implications. The current reliance, implemented over the last years, on low or negative interest rates to sustain public debt is unsustainable and poses risks of inflation and financial instability. Instead, a fundamental reform reducing public debt and promoting productive investments is necessary.

The ongoing initiatives like China's Belt and Road Initiative and proposed digital currency standards signal a shift towards a new international financial order. This reform must complement prudent financial mechanisms to prevent systemic failures and ensure sustainable economic growth. Ultimately, addressing the challenges of public debt and monetary reform requires concerted efforts on a global scale, acknowledging the geopolitical dimensions and adapting to the realities of the contemporary world.

Behind the Research



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Research Objectives

Jean-François Serval and Jean-Pascal Tranié advocate for the conversion of public debt into equity in productive businesses, fostering innovation and economic growth.

Detail

Bio

Jean-François Serval is president of Groupe Audit Serval & Associés, a multinational accounting firm, operating in Europe, Asia, and the American continent. Serval is also founder and head of the United States operations of Constantin Associates, a subsidiary of Groupe Audit Serval

& Associés. He is a member of the European League for Economic Co-operation and the International Fiscal Association.

Jean-Pascal Tranié is the founder and President of Aloe Private Equity, a regulated fund management company.

Collaborators

- Jacques de Larosière, former Managing director of the IMF, former governor of the Banque de France.
- Raphaël Douady, member of the Centre d'économie de la Sorbonne, former Frey Chair at Stony Brook University.

References

Serval, JF, Tranié, JP, (2023) *Financial innovations and monetary reform: How to get out of the debt trap*, Switzerland: Springer Nature. doi.org/10.1007/978-3-031-24189-5



Personal Response

What do you believe is the most critical aspect of addressing the challenges of public debt and monetary reform?

“ The most critical point in our approach to successfully reforming the international monetary system is probably a political one, ie, getting the major economic powers to agree on a new monetary order at a time when the rivalry between the USA and China for world leadership is becoming increasingly conflictual. ”

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issues, offers a solution. These funds would buy back existing assets or create new ones, exchanging them for debts held by institutions. This process, while issuing new money, wouldn't impact the real economy, as this conversion would relate to future commitments, essentially retirement pensions, which do not interrupt immediate payments. However, the transition necessitates careful consideration of voting power transfers and the concession of public assets to the private sector. Ultimately, this approach safeguards against interest rate manipulations and proposes a coordinated international effort to

or negative-rate public securities for products with progressive rates, ensuring better long-term profitability for holders.

While most public debts can be cleared within economic zones, reserve currencies, the dollar for the essentials, present a unique challenge due to their extensive international use. To ensure the overall coherence of the monetary system, the researchers' plan provides a decentralised debt transformation, facilitated by structures like hive-off funds, which manage investments while ensuring liquidity to honour debt commitments, particularly for pension