THE EVOLUTION OF A RENTIER ECONOMY AND THE SUPPRESSION OF ECONOMIC WELFARE

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ABSTRACT

The paper highlights the importance of a fair distribution of wealth among the economic agents of a country so that the benefits of a free-market economy work efficiently and create new wealth that fosters economic welfare are at work and functioning efficiently. Extreme inequality and a dysfunctional banking system deprives the market economy from entrepreneurial skills and innovation. In addition, the risk aversion attitudes of the wealthy lead to an elusive pursuit of return without the risk, but which inevitably, through a dysfunctional banking system, results in the transfer of existing wealth from the many to the very few rather than creating new wealth. And the real economy is thereby trapped in a vicious circle which further exaggerates wealth concentration and inequality.

Keywords: Economic development, wealth, inequality, risk analysis, project evaluation, corporate lending, credit risk.

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Wealth and money

Wealth approximates to the *net worth* of individuals. Whether we realise it or not we all have a *balance sheet* as at a specific point in time and an *income statement* (profit and loss) that applies for a given time-period. This is as true as are the laws of the universe. The fundamental truth is that everything is owned (and is also *owed*) to some physical or legal entity. The *net worth*, or owner's equity, is the difference between assets and liabilities of one's balance sheet and represents the wealth that accrues to the entity it refers to. A balance sheet that has no liabilities simply means that the sum of *all assets* in its balance sheet are a correct and accurate measure of the wealth that ensues to that physical or legal entity (company or institution).

This is true even in a barter economy (one without money). It simply means that an economy is made up of agents who own and *exchange wealth* between them. Whether their wealth is their physical assets (*land, property*) or their *labour* services, people engage in the act of exchange with others and in the process, they *create new wealth* as the most competent specialise and focus on the production of goods and services they are best at and more economically efficient with.

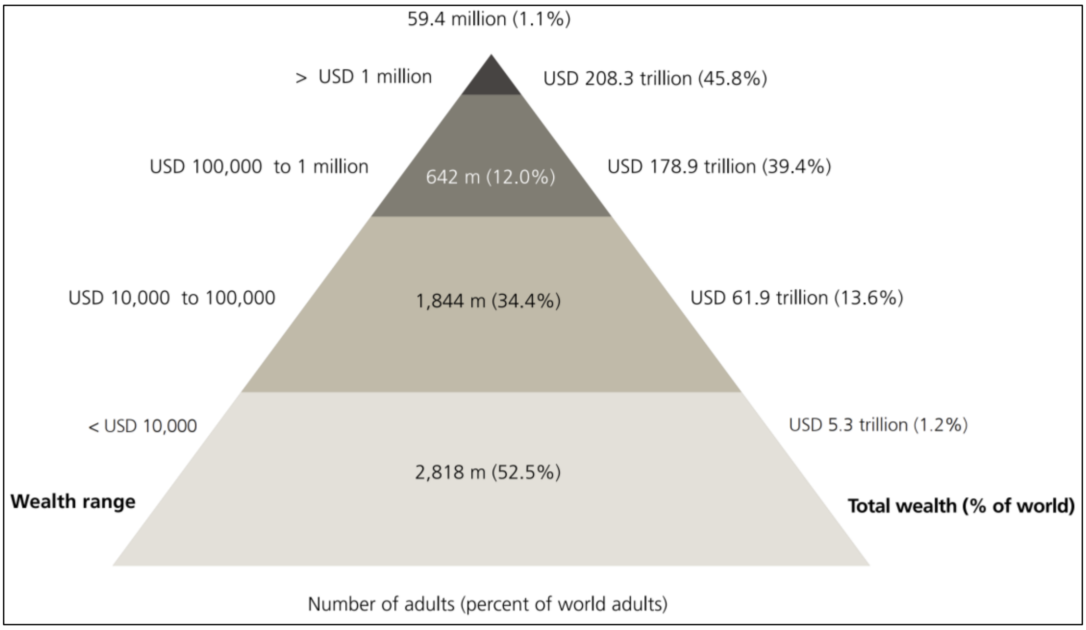
Money facilitates the act of exchange but it has no intrinsic value itself. Money is at best a means to acquiring wealth. It is a promise to pay. Nothing more. And a promise is only as good as the one who makes it is trustworthy and able to fulfil it. Moreover, a payment in money changes with whatever the amount of money promised can purchase at the time it is demanded. Hence, although cash is an asset in one's balance sheet it is not wealth in the sense of having goods and services. Cash is only wealth in as much as it is possible through it to acquire real assets.

In an economy that does not create new wealth and thereby add new assets, the value of money is likely to diminish as "too much money would be chasing too few goods", which is of course the definition of inflation. It is therefore imperative that a productive economy creates new wealth for all rather than being employed to transfer existing assets from the many to the very few. So, what you are, in effect, arguing is that inflation is the result of inequality**.**

Extreme wealth inequality

Wealth is not something that can be easily gauged, let alone to be measured with accuracy. As an indication however of the concentration of assets in the hands of the few, the pyramid in Figure 1 summarizes the distribution of wealth among adults worldwide ([1] Davies, Lluberas and Shorrocks 2023). The wealth share of the global top 1% is estimated to be 44.5%. As noted in the report: "the number of global millionaires has been growing rapidly in recent years and exceeded 1% of adults and in terms of wealth ownership, High Net Worth Individuals (HNW) is increasingly dominant. The aggregate wealth of HNWs has *grown five-fold* from USD 41.4 trillion in 2000 to USD 208.3 trillion in 2022, and their *share of global wealth has risen from 35% to 46%* over the same period."

Figure 1 - The Global Wealth Pyramid 2022



Source: Davies, Lluberas and Shorrocks, Global Wealth Databook 2023

Collateral lending and the depletion of equity

The value of money also decreases with the issuing of new money which is not employed in productive and economically viable uses. This is at the very core of today's dysfunctional banking system that is based almost exclusively on *collateral lending* rather than on a proper *assessment of repayment capability* of the borrower and the economic viability of the project to be financed, ([2] Savvides 2022b). The total of the balance sheet net worth of all individuals is therefore a notional measure of the wealth in a country. The wealth of a nation increases with productive and economically viable capital investment projects and decreases with ventures that use up more economic resources than they generate in customer benefits. Hence, economic welfare increases with the former while the latter decreases total wealth in an economy and often leads to wealth extraction.

Collateral lending has become the norm in a largely unregulated banking environment in the world today. The balance sheet position of the borrower is essentially the sole criterion for approving a bank loan today. In other words, loans are granted based on *the recourse* that may be available to the bank in case the loan is not performing. *The repayment capability* and whether the loan finances *productivity* is not, as it should be, *the prime criterion* for granting a loan. The departure from this vital premise by banks facilitates the creation of a rentier economy and, coupled with extreme wealth inequality in the world today, leads to wealth extraction and asset transfer rather than wealth creation resulting in debt peonage and a suppression of general economic welfare.

An economy where reckless collateral lending is allowed to deplete the equity of the balance sheets of its people (households and enterprises) amplifies inequality by transferring existing wealth from the many to the few rather than in creating new wealth for all. This inevitably leads to economic decline and recession through debt peonage as the economic agents of the country cannot participate in the productive wealth creation process.

The evolution of a rentier economy

The extreme wealth inequality that exists today and the risk aversion of the wealthy has resulted in wealth extraction rather than wealth creation where debt peonage, through a defunct and lightly regulated banking system, transfers existing wealth and resulting in a rentier economy. A rentier economy is one that extracts rents from existing assets rather than from creating new ones that add to the total wealth of a country. The term usually refers to “unearned income” through finance, insurance, and real property (often denoted by the acronym FIRE). Rents in the main provide the owner of such assets with a secured and relatively riskless income.

Even economists who have defended the existence of rentiers could only do so on the premise that banks finance productivity. Consider the statement put forward at the end of the 19th century against what was core in the economics of Adam Smith, John Stuart Mill and Alfred Marshall whose analysis led to the idea of state support for industry rather than landowners and the financial classes, who were getting a free lunch by extracting rather than creating wealth. By the late 19th century, the rentiers fought back by arguing, like John Bates Clark, that economic rent was earned rather than unearned. Bates Clark redefined it as payment for the landlords’ labour and enterprise, not as accruing “in their sleep” as J. S. Mill had characterized it. Interest was depicted as payment for the “service” of lending productively, not as exploitation. It is rather astounding that even the biggest defenders of financiers then could only seek to justify interest if the loan was a productive one. Indeed, this was the argument put forward to defend the position of the rentiers that they are not getting a “free lunch” and that they earn it by providing a key service to the real economy. The charging of interest was justified as the *earned payment for the “service” of lending productively,* ([3] Hudson 2019).

Risk aversion and the derailment of the real economy

The pursuit of a return without the risk amidst a largely deregulated financial markets environment systematically derails and compromises the real economy. As pointed out in ([4] Savvides 2022a), “*Risk aversion by the wealthy and the depletion of entrepreneurs’ equity through unproductive debt combine to create two destructive separations Risk from Return and Ownership from Entrepreneurship”.* Extreme inequality and the risk averse attitudes of the wealthy distort and misdirect the real economy.

Risk and return are two sides of the same coin. An attempt to separate one from the other inevitably leads to wealth extraction rather than wealth creation. The pursuit of a return without the risk amidst a largely deregulated financial markets environment systematically derails and compromises the real economy. The depletion of equity through unproductive lending creates a separation of ownership from entrepreneurship causing the real economy to underperform.

Extreme wealth concentration such as the one that the world is experiencing inevitably becomes an obstacle which impedes an economy from reaching its full potential through productivity and free market exchange of the many in the real economy. It is therefore imperative that wealth should be widely available and spread out among the various economic agents of an economy to facilitate *entrepreneurial specialisation* and to *enable a process of efficient exchange* to take place in a *competitive free market environment. The real economy suffers from the deprivation of the* economic efficacy that results from entrepreneurship and which in turn fosters economic development and enhanced welfare for the public at large.

An equally important reason against extreme inequality relates to the *risk averse attitudes* of the elite that have come to own the wealth. Not only do they lack the skills and competence but also, and to some extent because of that, they opt towards investing in relatively *low risk capital investments*. Inevitably, this leads to *rentier and non-productive activities* that only exaggerate inequality and tend to transfer existing wealth from the many to the very few ([5] Paravisini, Rappoport, Ravina (2016).

The depletion of owner equity and the suppression of economic welfare

A dysfunctional banking and financial system encourage the flow of funds to *unproductive and economically non-viable* uses, ([4] Savvides 2022a). Lending is granted primarily and, in some cases, even totally on security considerations and collaterals that can be provided by the borrower rather than based on economic viability rather than after a proper *assessment of repayment capability* of the object of financing. This unavoidably leads to *broken balance sheets* and the depletion of available equity for productive investments. Funding is hence directed towards the capture of existing assets rather than financing viable productive projects in the real economy.

In conclusion, wealth concentration and extreme inequality suffocate the real economy and lead to a transfer of existing wealth from the many to the few rather than creating new wealth that enhances general economic welfare. The *depletion of owner equity* through a dysfunctional banking system leads to a *separation of ownership from entrepreneurship* and the relentless pursuit of the wealthy for a *return without risk* causes the suppression of economic welfare.

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