

Fictitious capital and the rise of the Dow

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As the Dow Jones industrial index edged towards 10,000 in Wall Street trading earlier this month, a commentator on the CNBC business channel was heard to remark: "Let us wait a while and see if we can add some more value."

Then there was a somewhat nervous laugh, as both he and his co-commentator seemed to realize, if only for a moment, how ludicrous the comment sounded.

But in fact it was no more ridiculous than many of the other statements that have accompanied the surge on Wall Street over the past few years. There have been claims that the United States is now a "new economy" and that the stock market boom signifies the emergence of a "new economic paradigm" based on information technology. Last year, the US Federal Reserve Board chairman Alan Greenspan, who had warned of "irrational exuberance" in December 1996, joined the chorus, proclaiming that it seemed that the US had moved "beyond history", so that fluctuations in the business cycle no longer applied.

In order to pierce the web of illusions that surround the stock market boom, and which seem to lend credence to such claims, it is necessary to grasp what is actually involved in share trading, and its relationship to the functioning of the capitalist economy as a whole.

The buying and selling of shares on the stock market represents neither the creation of new value, nor the injection of increased capital into the firms whose shares are being traded--except in the case of new issues, which comprise a relatively small part of the market. When, for example, a General Motors share is bought and sold the capital of the company does not change, its physical assets remain the same and its profits do not increase. All that has changed is the ownership of the company, in particular the entitlement to a share of the profits expected to be generated in the future.

The illusions surrounding stock market trading are by no means a new phenomenon. In fact they were analyzed in a work published by the Austrian Marxist economist Rudolf Hilferding at the beginning of the century.

In his book *Finance Capital* Hilferding explained that

the money, which circulates in the share market is quite different from the initial funds advanced to the corporation and used to purchase industrial capital.

The money that is acquired from the sale of shares, he noted, "is not the same money which was originally supplied by shareholders and then used in production. It is not a constituent part of the corporation's capital, but rather an additional quantity of money required for the circulation of the capitalized claims to income."

In this process there appears to be a doubling of the amount of capital. There is the capital, which has been deployed in the establishment of the corporation, plus the capital that circulates on the stock market in the buying and selling of shares. This rise in the latter forms the basis of the illusion that the stock market is "creating value".

"The share," Hilferding explained, " ... may be defined as a title to income, a creditor's claim upon future production, or claim upon profit. Since the profit is capitalized, and the capitalized sum constitutes the price of the share, the price of the share seems to contain a second capital. But this is an illusion. What really exists is the industrial capital and its profit. But this does not prevent the fictitious 'capital' from existing in an accounting sense and from being treated as 'share capital'. In reality it is not capital, but only the price of a revenue; a price which is possible only because in capitalist society every sum of money yields an income and therefore every income appears to be the product of a sum of money" [Rudolf Hilferding, *Finance Capital*, pp. 110-111].

Hilferding pointed out that the illusion was assisted in the case of industrial capital because, in addition to shares, there does exist actually functioning industrial capital. The nature of fictitious capital, however, became apparent by considering other forms of claims to revenue. Bonds issued by the state, for example, continue to claim a portion of the income raised through taxation, even though the money issued by the state's creditors may have been used to finance the purchase of assets that could have long ago "gone up in smoke."

In words which have a direct relevance to the surge in

the Dow Jones index, Hilferding continued: "On the stock exchange capitalist property appears in its pure form, as a title to the yield, and the relation of exploitation, the appropriation of surplus labour, upon which it rests, becomes conceptually lost. Property ceases to express any specific relation of production and becomes a claim to the yield, apparently unconnected with any particular activity. ... Number is everything; the thing itself is nothing" [op cit p. 149].

Hilferding noted that profit arises from the appropriation of the labour of the working class for which nothing is given in return. Its source lies in the fact that the value of labour power, which the worker receives in the form of wages, is only a fraction of the value added by the worker in the process of production. Share trading cannot lead to the creation of new value because share market trading is speculation; one trader's loss is another's gain.

This being the case, the question that arises is: what is the source of the vast increases in wealth that have resulted from share trading? Such gains are only possible provided there is a continuous stream of new money into the stock market, which boosts the value of shares, thereby enabling all traders to benefit ... so long as the inflow of new money continues. It is in this process that the origin of the share market boom resides.

The sources of these new funds include international investors, banks, insurance companies and other financial institutions and, above all, retirement savings deposited in mutual funds, which have been flooding into the stock market at an unprecedented rate.

According to the Investment Company Institute, which monitors these flows, mutual funds were the source of \$5.9 billion of "new money" that went into the stock market in 1984. There has been a spectacular rise in the past decade and a half. By 1994 these funds were the source of \$119 billion, and by 1997 that figure had nearly doubled to \$227 billion. Last year, the flow of new money fell back to \$159 billion, leading to a slowdown in the rise in the market.

Other statistics reveal the same processes. It is estimated that the number of households with investments in mutual funds has risen from 10 million a decade and a half ago to around 40 million today. The average American household now has around one quarter of its savings invested in the stock market, compared to a figure of only 8 percent 15 years ago.

The increase in the flow of cash from mutual funds in the middle of this decade is reflected in the rise in the

market. In the first half of the 1990s, the Dow rose at an annual rate of about 7 percent. But since 1995 growth has been about 25 percent per year with the result that the Dow is now two and a half times its level at the start of that year.

Viewed over a longer period, the rise is even more spectacular. In 1982, the Dow hit a low point of 717. Now it is on the verge of breaking the 10,000 mark. This is far in excess of the 450 percent rise that took place in the bull market of the 1920s.

For this spectacular growth in fictitious capital to be realized, there would need to be a similarly rapid rise in the real economy. But here the figures show an opposite trend to the share markets.

Even with the increases in the past two years, the growth rate in the US economy since the last business cycle peak in 1989 has been the slowest of any period since World War II. The average growth rate in the last decade has been 2.3 percent. This compares with a growth rate of 2.7 per cent in the business cycle of the 1980s, 3.2 percent in the 1970s and 4.4 per cent in the 1960s.

The rate of jobs growth has also been slower, increasing by only 1.6 percent in the 1990s. This compares with 1.8 per cent in the 1980s, 2.5 percent in the 1970s and 2.8 percent in the 1960s.

Productivity growth shows the same tendency. While it has risen to 1.2 percent in the 1990s, compared to 1 percent in the 1980s, this is well below the 2.5 percent annual productivity growth recorded in the period from 1947 to 1973.

In other words, while the claims of "fictitious capital" have grown to gargantuan proportions, fueled by a massive inflow of money that can find no other profitable outlet, the growth in the real economy, which is ultimately called upon to meet these claims, is the slowest in the post-war period.

The stock market may continue to rise--at least while new money continues to pour in--but at a certain point the process will be reversed, threatening a social disaster for the millions of ordinary families who have placed their savings and assets at its disposal.



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