An exchange about the financial bubble in the US economy

Nick Beams
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The following is a reply by WSWS editorial board member Nick Beams to a reader's letter about Beams' July 8 article, "When will the US 'debt bomb' explode?"
http://www.wsws.org/articles/1999/jul1999/econ-j08.shtml
The reader's letter can be found at:
http://www.wsws.org/articles/1999/jul1999/lett-j28.shtml

Dear IM,

Thank you for your e-mail commenting on my article "When will the US 'debt bomb' explode?" which reported on the findings by economist Robert Blecker, published by the Economic Policy Institute under the title "The Ticking Debt Bomb".

You criticise Blecker's conclusions on the grounds that his figures "vastly overestimate the increase in foreign asset holdings". I am sure Blecker is well able to defend his findings for himself. I will merely point out that the specific measurement you question, namely the estimate for the foreign asset holdings for 1998, is a projection for one year only and appears broadly in line with the statistics for the previous years.

In my view the most significant aspect of his findings is not the absolute level of the US foreign debt, large as it is, but the fact that, whereas in the early 1990s total investment income still remained positive, since 1997 it has become negative. The chief cause of this turnaround is the increase in financial investments held by foreigners in the US.

In seeking to downplay the extent of the deepening financial crisis you note that "if the stock market suddenly crashes, the value of foreign-held equities will also crash, eliminating the equity part of the 'problem' in the course of an afternoon." To be sure it will. But the same process will "eliminate" vast areas of US-owned finance capital as well—hardly a solution to the financial crisis.

You go on to point out that the debt service on US bonds is around $78 billion and less than 1 percent of GDP. I do not consider that the level of debt service in relation to GDP is the central issue. Of much greater significance is the relationship between the influx of foreign capital into the US bond market and the level of the dollar. Despite a widening trade gap, the US dollar has been able to sustain its value in the recent period because of the inflow of foreign capital into the bond and equity markets, an inflow which has ensured that interest rates have not risen.

However, if the trade deficit continues to widen at its present record rate, and doubts emerge about the dollar's value, then there can be a very rapid movement of these funds out of US bonds. Such a movement would bring an escalation in interest rates, leading to a possible plunge in the share market and a further fall in the dollar. It is worth recalling that on the last occasion there was a major crisis of confidence in the dollar, during 1978-79, US interest rates were hiked up to more than 20 percent in the early 1980s, leading to the deepest recession in the post-war period. In today's far more highly-leveraged conditions, in which industrial corporations and financial institutions alike have borrowed vast amounts of money in order to buy stock, the consequences of anything approaching such an interest rate rise would be even more severe.

In other words, the basic point at issue here is not whether debt servicing can be sustained, but the possibility that a sharp movement in the dollar sparks a rapid outflow of funds. A rapid fall in the dollar is certainly a possibility. In the middle of the financial crisis last year, for example, the dollar-yen rate changed

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by as much as 17 percent in a few weeks.

The last point you raise on increased productivity due to the development of information technology is the most important. You draw attention to the fact that information technology has both increased the productivity of workers and increased capital's share of workers' output. We are the last to deny this. In fact we have sought to demonstrate how the increase in labour productivity, stemming from the development of information technology, has intensified the historic crisis of the capitalist mode of production.

Broadly speaking, the crisis centres on the fact that while information technology and other innovations vastly increase the amount of material wealth which can be produced, these same processes work to depress the rate of profit and consequently the rate of capital accumulation. This contradictory result is rooted in the very structure of capitalist social relations. While the ultimate source of all profit, interest and rent is the surplus value extracted from the working class (the wage workers employed by capital), the development of new technologies in the drive to reduce costs leads to the diminution of living labour in the production process.

But because living labour is the source of all surplus value, the mass of surplus value available to capital tends to decline. In other words, the greater the productivity of labour, the more difficult it becomes for capital to secure sufficient profit to expand at a given rate.

The emergence of falling profit rates sets in motion two processes. On the one hand capital engaged in the production process seeks to increase profits by driving down the wages paid to labour, and secure even cheaper sources of labour. On the other hand, faced with declining profit rates in industry, capital seeks to secure a profit through speculation—the buying and selling of assets such as shares and bonds. There is no doubt that such speculation can, for a period, postpone the emergence of the underlying profits crisis. As long as capital flows into the share markets and stocks continue to rise, then previously invested capital can return a profit. But this process cannot go on indefinitely. In the final analysis, shares are fictitious capital. That is, they represent anticipated future income, and that future income ultimately depends on the surplus value that can be extracted from the living labour of the working class.

Three years ago, when US Federal Reserve chairman Alan Greenspan pointed to "irrational exuberance", the Dow stood at around 6500. Now it is around 11,000. No doubt some of this increase is due to increased productivity, but it has not brought about the near doubling in the ratio of stockmarket capitalization to US GDP over the same period.

Marxists are the last to deny that increases in productivity have changed US and world capitalism, if for no other reason than it is our understanding that the development of productivity intensifies the crisis of capitalism on the one hand and lays the objective basis for the development of a socialist economy on the other.

It is worth remembering that the period in which the US economy experienced its greatest ever productivity rise was the 1920s. It too was accompanied by a booming share market and claims that a "new economy" had been created.

Yours sincerely,

Nick Beams

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