The implications of the US economy's reliance on a huge capital inflow

Nick Beams
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Dear *WSWS*,

As usual Mr. Beams' analysis [25/5/2000] of the latest statistics on the US trade position are sobering and penetrating.

While reading his article a question came to mind in relation to the second paragraph, i.e. "Apart from seeking to push down wage demands, financial authorities in the US have lifted interest rates in order to ensure that the inflow of foreign capital needed to fund the trade gap continues."

Has this feature of the present crisis, i.e. the reliance on the enormous inflow of foreign capital to fund the huge trade gap, been a feature of previous crisis periods in United States economic history or is this a new development in financial crises?

Yours sincerely,

AC

Dear AC,

The short answer to your question is that the US reliance on the inflow of foreign capital is a new feature of world capitalism.

Up until World War I the US was a net debtor country. Borrowed funds, channelled through London, financed the growth of American industry and infrastructure such as the railways.

By the conclusion of the war the US had become a creditor nation and assumed the position of the world's leading financial power. After World War II, this dominance formed the basis of the financial arrangements set up under the Bretton Woods Agreement of 1944 in which the dollar effectively became a world currency. Under the post-war arrangements, the major currencies were tied to the dollar, which was backed in turn by gold at the rate of $35 per ounce.

However, the post-war system of fixed exchange rates was marked by a profound contradiction. While on the one hand the world needed an increasing supply of dollars to finance trade and investment, on the other hand this outflow undermined the relationship between the dollar and gold.

The growing crisis came to a head at the beginning of the 1970s when the US began to experience a balance of trade deficit. The only way that the dollar-gold relationship could have been maintained was to initiate a major recession in the US and internationally. On August 15, 1971, President Nixon sought to resolve the crisis by removing the gold backing from the US dollar, and in March 1973 exchange rates between the major currencies were floated.

Even though the US was experiencing growing balance of payments problems, it still remained a creditor country. However, by the mid 1980s large-scale international borrowing by the US to finance its budget deficit transformed the United States from the world's largest creditor nation to its outstanding debtor.

This situation contains a potentially explosive contradiction inasmuch as the world's major currency is that of its most indebted nation.

The debt situation has been worsened by the events of the recent period—in particular the growth of the stock market bubble over the past four years. It is worth noting that even taking account of the recent falls, the increase in the value of US stocks since 1994 is more than $10 trillion.

The expansion in the US economy has been increasingly financed by the growth of debt, both internally and from abroad.

Not only is the US experiencing record trade deficits, but an outflow of income. The deficit on net income more than doubled from $12.2 billion in 1998 to $24.8 billion in 1999, largely as a result of rising interest payments on growing US foreign debt. Interest payments on this debt rose from $66.4 billion in 1998 to $77.6 billion in 1999.

If present trends continue, the US net international debt will reach $1.9 trillion by the end of this year, and double to $3.8 trillion by the end of 2005. Of course such tendencies carry with them the prospect of a massive financial crisis if investors decide to place their money elsewhere.

The worsening debt position of the US is the subject of increasing concerns in the financial press. An article by *Financial Times* commentator Martin Wolf, published on May 23, for example, noted the following imbalances in the US economy: “the most highly valued stock market in US history; the biggest private sector financial deficit since the second world war [the result of increased borrowing by corporations N. B.]; a record current account deficit; net external liabilities at 20 percent of GDP and rising; and a ratio of debt to net worth in non-financial corporations double that in 1980s.”

Pointing to the way in which rising stock market values have provided the basis for greater borrowing by companies, Wolf noted: “Soaring demand has been generated by the increase in the private sector's net financial deficit, itself largely explained by the wealth effect of the stock market. A big shock could reverse this, as has happened in many other countries. Bill Martin of London-based Phillips & Drew notes that there would be a direct impact on aggregate domestic demand of 6.5 percent on GDP if the private sector financial deficit were to revert to its historic average. This could then generate a vicious feedback impact on profits and the stock market and, in consequence, a brutal recession.”

Regardless of how future economic events unfold, it is clear that the historically unprecedented indebtedness of the US economy—both internally and externally—contains the potential for far-reaching instability within the global capitalist economy.

Yours sincerely,

Nick Beams