

# Federal Reserve conference spotlights financial instability

**Nick Beams****1 September 2000**

This year's annual conference of US Federal Reserve Board officials and economic policymakers at Jackson Hole, Wyoming threw some further light on the increasingly unstable financial position of the US economy and pointed to concerns in ruling circles that a decline in economic growth could have major political ramifications.

In his address to the conference, Federal Reserve Board chairman Alan Greenspan warned that "deep-seated antipathy toward free-market competition" could emerge if economic growth began to falter.

"Any notable shortfall in economic performance from the standard set in recent years ... runs the risk of reviving sentiment against market-oriented systems even among some conventional establishment policymakers. At present, such a shortfall is not anticipated, and such views are not widespread. But they resonate in some of the arguments against the global trading system that emerged in Washington, D.C. and Seattle over the past year."

One of the most noteworthy features of Greenspan's speech was that it pinpointed what could well be called the "dirty secret" of the US economic boom and the inflow of foreign capital upon which it has become increasingly dependent.

According to Greenspan, one of the main reasons why there was a greater level of high-tech capital investment in the US than in Europe and Japan was that "by law and by custom, American employers have faced many fewer impediments in recent years to releasing employees." In other words, US firms are more profitable because of the greater ease with which they can carry out mass sackings and downsizing as compared to their rivals in other countries.

"This difference," he continued, "is important in our new high-tech world because much, if not most, of the rate of return from new technologies results from cost reduction, which on a consolidated basis largely means the reduction of labour costs. Consequently, legal restraints on the ability of firms to readily implement such cost reductions lower the prospective rates of return on the newer technologies and,

thus, the incentives to apply them. As a result, even though these technologies are available to all, the intensity of their application and the accompanying elevation in the growth of productivity are more clearly evident in the United States and other countries with fewer impediments to implementation."

As a result of the greater rates of profit in the US, Greenspan noted, "Europeans have been finding investments in the United States increasingly attractive and have accounted for an increasing share of the expanding total of foreign investment in US direct and portfolio assets."

These conclusions have decisive political implications. They point to the fact that one of the most crucial factors in the continued ability of the US to suck in the foreign capital needed to finance its growing international debt and rising balance of payments deficit—now running at around \$400 billion per year or 4 percent of gross domestic product—is the suppression of all independent struggles by the working class for wages or in defence of jobs.

A paper by economists Maurice Obstfeld and Kenneth Rogoff focused on the escalation in the US current account deficit in the recent period. After running at an historically high rate of 1.7 percent of GDP from 1992 to 1998, the deficit surged to 3.7 percent of GDP in 1999 and is expected to reach 4.4 percent in 2001.

While among the major capitalist nations this was still below the level of Australia (which recorded a deficit averaging 4.3 percent from 1991 to 1999), the deficit of \$316 billion was "still the largest imbalance in history, in absolute terms". This raised the question as to how long the global economic system could sustain such borrowings from its largest member and what the consequences would be of a sudden reversal.

The authors pointed out that by the end of the year 2000 the net indebtedness of the US would be around \$1.9 trillion or 20 percent of GDP and that even if the current US growth rate of 5 percent per annum could be sustained, an ongoing current account deficit of 4.4 percent of GDP "would imply a sharply rising foreign debt-GDP ratio into the foreseeable

future."

The paper pointed out that while the 20 percent debt to output ratio seemed manageable it was "extremely high by historical standards."

"At the end of the 19th century, when the US was an emerging economic giant, its debt-GDP ratio never exceeded 26 percent (a high-water mark reached in 1894). If today's trends continue, that figure will shortly be surpassed. One only has to recall that prior to the Latin American debt crisis in 1980, Argentina's net foreign debt stood at 22 percent, Brazil's 19 percent and Mexico's 30 percent, to see that the US external debt-GDP ratio has already reached a high level."

The mere fact that the US debt position is even being mentioned in the same breath as debt-ridden Latin American countries indicates that while official pronouncements continue to hail the wonders of the "new economy" there are signs of growing instability.

The Obstfeld-Rogoff paper pointed out that while other advanced capitalist countries such as Canada, Finland and Sweden had experienced debt to GDP ratios of 40-50 percent, and even 60 percent in the case of Australia, the international financial system could not support such a debt level in the world's largest economy.

"The most obvious 'shock' would be a sudden decline in the US growth rate relative to the rest of the world, perhaps also leading to an investment collapse. Such a shock might cause foreigners to reduce the flow of savings into the United States and, at the same time, induce a greater flow of US savings abroad—both factors would tend to reduce the US current account deficit."

In their conclusion, the authors warned that a "sudden adjustment of the US current account could involve a very large depreciation of the dollar". Such depreciations had "wreaked havoc" in other countries and while the US economy was more resilient "the risk of such a steep and rapid depreciation is real."

On the other hand, if nothing at all happened and US savings remained at their current low levels "the US economy might eventually face the worst of both worlds—a big external debt and a heightened chance that foreign investors panic and force a sudden end to US foreign borrowing."

The paper presented by Princeton economics professor and *New York Times* columnist Paul Krugman was significant not for any fresh insights it offered but because it expressed the general bewilderment of the entire bourgeois economics profession in the face of the increasing instability of the global capitalist system.

According to Krugman: "Anyone who has followed international financial affairs over an extended period of

time knows the feeling; call it conventional wisdom *déjà vu*. You are listening to or reading about some current debate in which there are certain propositions that everyone takes as given, and suddenly you get a dizzy feeling, because you remember the propositions everyone took as given five or 10, or 15 years previously—and they weren't the same propositions."

While the Asian crisis had led to a "torrent of both academic and policy papers, no canonical model of that crisis had emerged" with economists still divided over whether it was a "temporary jump to a bad equilibrium" or the result of an "inherently fragile system."

"This lack of agreement over the nature of modern economic crises makes assessing the effects of other factors on vulnerability to crisis difficult, to say the least: if we can't agree on what happened, how can we say whether increasing trade or whatever makes it more or less likely to happen again?"

Krugman offered the general conclusion that the "growing integration of the world economy has increased the risk of financial crises. Basically, growing potential gains from trade and foreign investment make it increasingly expensive for countries to maintain controls that might interfere with inflows of goods and services or deter multinational enterprise. But removing these controls makes it more likely that countries will develop the financial vulnerabilities that make financial crises possible."

While holding out the prospect that the risk of crisis could be weakened and eventually things would start to get calmer again, the "closer integration of the world economy is ... likely to mean an increased risk of crisis in the years ahead" and the "best guess is surely that the ride will continue to be very bumpy for many years to come."

What the highly-paid economist euphemistically calls a "bumpy ride" means for the majority of the world's people, including the population of the United States, economic chaos, bankruptcies and the destruction of jobs and living conditions of which the Asian crisis was a foretaste.



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