A big fat lie

The economic recovery

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> Turning and turning in the widening gyre
> The falcon cannot hear the falconer;
> Things fall apart; the center cannot hold;
> Mere anarchy is loosed upon the world,
> The blood dimmed tide is loosed, and everywhere
> The ceremony of innocence is drowned;
> The best lack all conviction, while the worst
> Are full of passionate intensity.
> — W.B. Yeats, "The Second Coming"

The scenario of current economic affairs, were it not for its brutal reality, might be taken as a case study in the ironic nature of the so-called "economic recovery." While big business and their associate political collaborators have been heralding recovery for the past year, unemployment continues to ride at a national level of 7% topping at least 12% in industrial areas such as Detroit, inflation is still hovering at 4%, cut-backs in social services are still being enacted, and large cities across the country are increasingly at wit's end for funding their skeletal remains.

As the situation now stands (or wobbles), there are as many signs pointing to renewed depression as to recovery, and the only forecast being made with any confidence is that prices will go up. Although sales in a number of industrial sectors have picked up recently (notably the automobile industry), and even though the stock market has wormed its way up to new highs, the following statement by a Wall Street analyst is more indicative of the present economic mood:

> "The overriding fear is that we are on the threshhold of another cycle of tight credit and sky-high interest rates, with the Fed simultaneously battling against inflation and recession..."
> —*Wall Street Journal*, May 13, 1976

What's behind this statement is the fact that the value of money is still decreasing and that business as a whole is not expanding (in the cyclical nature of capital, a necessary factor following a recession is capital growth).

Business has not been expanding. What has occurred is that the 1974–75 recession created a certain demand for consumer goods following a period of huge over-production as characterized by a record GNP in 1973.

Many people hesitant of making major purchases in 1974 and 1975, saved enough to plunge into 1976 with a buying spree based less on confidence in the recovery than on the sheer itch to get while the getting's good. But, for whatever confidence there was, it is again on the downturn and numerous surveys have recently come up with results showing a new decline in consumer confidence and buying:

"Yesterday, the nonprofit Conference Board repeated that its index of consumer confidence sagged enough in the past two months to more than offset a January-February gain. The research organization's buying-plans index, covering cars, homes and appliances, reached the lowest level since last spring."

—*Wall Street Journal*, May 27, 1976

For business to expand it must obtain funds. And funds for expansion are obtainable in only three ways: (1) through profits from sales; (2) through the sale of stocks or bonds; or (3) through bank loans. The problem is that corporate expansion inevitably reaches critical proportions where the cost of expansion necessary to profitably increase production exceeds the financial limits of a corporation. As the rate of profit of a corporation declines due to its increased costs and competition, it must decrease costs and whenever possible eliminate the competition. Mass production, use of capital intensive technology, labor over-time, and expansion are the usual methods employed.

Under a falling rate of profit, expansion must soar in order to make in large quantity sales what used to be made in low quantity sales. With large-scale corporate profits today in the vicinity of 3 to 5%, a decline of 1.5 to 2.5% would necessitate an expansion double the existing level in order to simply maintain quantitatively previous profit levels.

Expansion and Loans

Although many corporations have been reporting increased profits for the first half of 1975, a large portion of the profit must be dispersed as stock dividends. Profits today are rarely great enough to provide the huge amounts necessary for capital expansion. This leaves the sale of stocks and/or bonds or loans as means of raising funds for expansion.

The problem with loans is that corporations have been becoming increasingly dependent on loans for capital expansion ever since World War II. In fact, corporate liabilities have increased over 540% over the last twenty years while liquid assets have increased by only 70%. (Sweezy & Magdoff, *Dynamics of U.S. Capitalism*, p. 186). The ratio of liquid assets to short term liabilities is called the liquidity ratio and has decreased from 73.4% in 1946 to 19.3% in 1969 dipping to 10% in 1975. Increased earnings in 1976 coupled with the general policy of non-expansion and non-payment of dividends has increased liquidity to 17% in May 1971 which only slightly improves corporate financial health and proves again that no expansion is in process.

Further increases in short term loans would only push corporations closer to the point of insolvency.

Consequently, business demands for loan capital have fallen off tremendously:

"Other figures released by the Fed yesterday showed that loan demand continued sluggish in the week ended Wednesday. Since the beginning of the year such business loans have registered a cumulative decline of $4.29 billion."

—*Wall Street Journal*, May 14, 1976

The Stock and Bond Flood

This leaves essentially but one choice for corporations intent on raising funds for capital expansion, the sale of stocks and/or bonds. Recent events on the New York stock exchange prove this out in numerous instances.

U.S. Steel, for example, announced on May 26, 1976 its intention to sell 400 million dollars worth of debentures (i.e. securities of debt later convertible to stocks) in order to maintain "our competitive strength…as well as to increase our sources of revenue." Proceeds from the sale, in corporate jargon, are supposed to go for "facility expenditures and general corporate purposes." But with U.S. Steel's capital assets of $8.15 billion and total liabilities at $3.30 billion, and a long term debt of $1.59 billion at the end of 1975, it is much more likely that the funds are slated more for the payment of old debts than for capital expansion.

The daily column of the *Wall Street Journal* devoted to "Financing Business," lists corporations which plan to raise funds in the near future through the sale of stocks and/or bonds. Following the specific technical aspects of the sale is a description of how the funds are intended to be used. The following list (in abbreviated form) is for May 13, 1976:

> "GM Subsidiary Corp.—$300 million—proceeds to repay debt and other purposes. Masco Corp.—$60 million—repayment of bank borrowings and other corporate purposes. Potomac Edison—$25 million—to repay short-term debt and to help finance construction. Advent Corp.—440,000 shares—to repay short-term bank debt and other obligations."

Such data is by no means unique to May 13. The same column has been listing similar sales of debentures for debt payments for months.

Not surprisingly, corporations are not the only ones desperately searching for funds on the security market. Cities and states across the country, as well as the federal government, have also been posting bond issues and literally flooding the market with them.

"The tax exempt sector has been contending with huge new supplies in addition to the worsening background conditions. About $935 million of fresh state and city obligations are being offered this week and about $25 billion within 30 days, the heftiest one month volume ever."

—*Wall Street Journal*, May 1976

Compounding this internal flood of bonds is the continuous demand by foreign capitals for funds to expand, as shown by the recent entrance of both Brazil and Australia onto the U.S. bond market.

This tremendous increase in demand for capital has forced a growth in money supply as yet unbacked by any actual production, which in turn exerts a strong inflationary tendency on U.S. money.

"Figures released yesterday by the Fed indicated that the nation's basic money supply, known as M1, rocketed at an annual rate of more than 19% in the four weeks ended May 5. M2, a broader measure of money, jumped at a 15.6% rate."

—*Wall Street Journal*, May 14, 1976

Interest Rates—Up and Away

In an effort to reduce this expanded money supply in circulation, the Federal Reserve System has repeatedly increased the interest rate on federal funds, which are uncommitted reserves that banks lend to one another. This rate provides an indication of the availability of reserves in the banking system and also provides a base from which other short-term rates are scaled upward:

> "In the past few weeks the Fed moved to push the rate on federal funds upward, first to 4-7/8% from 4-3/4% and then to 5%."
>
> —*Wall Street Journal*, May 13, 1976

By May 20, the rate increased to 5-3/8% with little or no effect on the nation's increasing money supply.

> "NEW YORK (AP)—The stock market, unsettled by persistent interest rate worries, suffered its largest loss in more than a year Monday."
>
> —*Detroit Free Press*, May 25, 1976

Unsettled is putting it mildly: It is becoming increasingly clear that the tremendous demand for cash funds by corporations, states, cities and even the federal government is tied less to capital expansion and more to repayment of debt. This strain on the cash supply is the reason for increased interest rates and ultimately means that any institution now in debt must go deeper into debt in order to just maintain operating expenses.

"In times of crisis, the demand for loan capital, and therefore the rate of interest, reaches its maximum; the rate of profit and with it the demand for industrial capital, has to all intents and purposes disappeared. During such times, everyone borrows only for the purpose of paying, in order to settle previously contracted obligations."

—Marx, *Capital* v. 3, p. 513

Even though interest rates are still relatively low, there is no sign that the present trend will reverse itself. Actually it appears more likely that the continued demand for cash and further increases in the money supply will push interest rates higher as banks find it increasingly difficult to provide cash due to over-extended holdings of long-term notes.

Most analysts observe with a characteristically guarded optimism that the current events are normal to a recovery stage and claim that most investors are being unjustifiably pessimistic about rising interest rates and that industry is about to boom into an era of real growth and expansion.

If business were actually expanding, then circulation would be full, and "the rate of interest can be relatively high because of the demand for loan capital as a result of rising profits and increased new expenses." (Marx, *Capital*, V.3, p. 529)

However, as we have seen, the current demand for loan capital is more for the payment of debt than for expansion, and the increased money supply is now the cause of rising interest rates rather than being caused by them:

> "…the quantity of circulating medium reaches its apex in the period of over-tension and overspeculation—the crisis precipitously breaks out and overnight bank notes which yesterday were still so plentiful disappear from the market and with them the discounters of bills, lenders of money on securities, and buyers of commodities."
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> —Note by Engels in *Capital*, v. 3, p. 527

"Thus business always appears excessively sound right on the eve of a crash."

—Marx, *Capital*, v. 3, p. 484

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