Bourgeois Fantasies about Economic Bubbles

[This is a letter I sent to friends on Sept. 19, 2009, commenting on an article in the *New York Times* about the irrationality of people in creating economic bubbles. –S.H.]

Hi everybody,

I'm just back from a few days in Yosemite, and am catching up on the bourgeois economic "news". Needless to say, it's as ridiculous as ever!

The *New York Times* article below about how "crazy human nature" is leading investors and speculators to build up new economic and financial bubbles is a case in point. Bubbles, the article says, are irrational, and if only people were more reasonable, bubbles would not develop and the economy would permanently stabilize and develop just fine.

Trouble is, that's total crap. There are in truth various sorts of speculative financial bubbles (including the stock market itself). But capitalism is a system that *requires* the generation of *credit* bubbles to function at all. The primary bubble is the consumer debt bubble. Since the workers are not *paid* enough to buy back all that they produce, they *must* be granted ever more credit to buy back the goods which are put on the public market. True, the capitalists have the option of using the surplus value they extract from the workers to build more factories rather than to loan money to the working class and poor, and to an enormous extent they do this too. But building lots of new factories only makes sense if the market for what they produce is growing, and it can only grow if more and more credit is extended to the masses.

Most of the types of bubbles mentioned in the article are very secondary sorts of things, such as speculative bubbles around the prices of oil or gold. By far the most important of these "asset bubbles", though, has been the real estate bubble. These sorts of secondary bubbles do help enlarge the market for other goods, however, because of psychological factors ("the wealth effect") and also because asset bubbles themselves facilitate the expansion of the consumer credit bubble. Thus when home prices were zooming up every year, millions of Americans refinanced or took out second mortgages in order to buy all sorts of things they couldn't otherwise afford. (But because of this many are now losing their homes.)

However, the most important bubble after the consumer credit bubble is the *government debt bubble*. The basic idea here is that if the consumers cannot buy all that is produced, the government will buy an ever larger percentage of it. The capitalist holders of wealth (extracted from the working class) are even more willing to loan their ill-gotten gain to the government (rather than to individual consumers), because they think those loans are much safer. (And indeed they are – in the short run.)

The government debt bubble (at least in leading capitalist countries) can be expanded to an even greater extent than the consumer debt bubble. Not only are the wealthy more willing to loan money to it, but the government can also simply print money. When consumers alone (and the further growth of their debt) can no longer keep the economy going, then only the ever increasing government debt can do so. This is the situation we are in at present.

Capitalist economic crises were originally (in the 19th century) a problem primarily for individual capitalist companies (and the laid-off masses of course!). But in the capitalist imperialist era the developing economic difficulties have been transferred more and more to the government. Indeed, what we are seeing right now is the *further nationalization of the current economic crisis.* The current crisis is in fact being ameliorated for a while by the enormous increase in government debt, by bailing out major banks, financial institutions and even other major industries such as autos. This does not mean that the crisis is really *ending*, however! Instead, the economic crisis of the “private economy” is becoming more and more the economic crisis of the entire overall system, *including* the government. This is taking place primarily through the further, ever-more-rapid, expansion of the government debt bubble (which is then employed both to bail out private companies and to directly buy more and more commodities).

The other thing that must be mentioned about bubbles and the current crisis is the international situation, and especially the situation between the U.S. and China. The U.S. has created, and is ever expanding, a debt bubble vis-à-vis China and the rest of the world. This too can only be expanded so far before it finally pops. And let’s just say that the Chinese are already beginning to wonder whether they should pop the bubble now or later.

Bubbles, and their popping, are the big story when it comes to economic crises. And it is important to come to understand their real nature as something inherent in capitalism. But you’ll never be able to understand that from reading the *NY Times*! They can provide some useful statistics and so forth, but the analysis has to come from Marx!

Scott

The New York Times

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Same Old Hope: This Bubble Is Different

By Catherine Rampell

This time is different.

That's what people argue every time a bubble inflates, and what they think every time they are chastened by its popping. But century after century, decade after decade and year after year, human beings irrationally exuberate all over again.

Not long ago, the housing bubble burst and brought the global economy to a standstill. Now economists, recognizing that bubbles tend to come in bunches, are on the lookout for the next market to fizzle. They say that governments, central banks and international bodies should scrutinize a few markets that look likely to froth over in the next few years, like capital markets in China, commodities like gold and oil, and government bonds in heavily indebted countries like the United States.

"Globally, a lot of money is now seeking higher returns once again," said Rachel Ziemba, senior analyst at RGE Monitor. The steadying of the economy, liquidity injections by governments and big returns reaped early this year by investment banks are encouraging more traders to dip their toes back in the water in search of the next big thing.

"As long as compensation and bonuses are based on short-term performance in the market," she said, "that's going to encourage risk-seeking behavior."

Bubbles are episodes of collective human madness — euphoria over investments whose skyrocketing values are unsustainable.

They tend to arise from perceptions of pending shortages (as happened last year, with the oil bubble); from glamorized new technologies or investment frontiers (like the dot-com bubble of the 1990s, the radio bubble of the 1920s or the multiple railroad bubbles of the 19th century); or from faddish cultural obsessions (like the Dutch tulip bubble of the 17th century, or the more recent Beanie Babies bubble).

Often they are based on legitimate expectations of high growth that are "extrapolated into the stratosphere," as the economist Daniel Yergin, chairman of IHS-Cambridge Energy Research Associates, put it. Such is the fear over investment in emerging markets like China.

"I'm a long-term bull on Asia, but right now it's premature to be celebrating the 'Asian Century,' like some investors seem to be doing," said Stephen Roach, chairman of Morgan Stanley Asia.

The Shanghai Stock Exchange Composite Index, for example, nearly doubled from November to July before pulling back last month. "People seem to believe the baton of global economic leadership is being seamlessly passed from the West to the East. That's going to happen, but not for another 5 to 10 years at least."

Similarly premature excitement inflated what became known as the South Sea bubble, a 18th century mania over British trade with emerging Latin American markets. (Aside: Even the brilliant Sir Isaac Newton, seduced by the mirage of infinitely rising stock prices, lost a lot in the South Sea bubble — which is somewhat ironic, given his famous recognition that what goes up must come down.)

Economists also worry that commodity bubbles, which tend to be more cyclical, may strike again. Oil and gold prices are rising, and though both of those commodities have boomed and busted many times in the last century, investors may bet on unrealistically high growth once more. Gold prices, for example, have risen more than 30 percent from a year ago.

"With every commodity bubble, you see a whole new set of rationalizations," Mr. Yergin said. "People find ways to shut out the reality of economic processes. If oil prices shoot up, investors are always surprised to see demand go down again."

In each of these markets, the inflation and deflation of prices would be painful to investors but may not have as far-reaching consequences as the recent housing and credit collapses.

But a sovereign debt bubble — which many argue is driving the acceleration in gold prices — could prove far more dangerous.

So many countries, like the United States, are running up such large national debts as a percentage of their overall economies that they could risk eventual default. Even without outright default on their obligations, the value of government bonds sold to finance these deficits could plunge, costing investors a lot.

"Talk about a big bubble that really affects the global economy," said Kenneth Rogoff, an economics professor at Harvard whose new book, "This Time Is Different," chronicles 800 years of debt-driven financial crises.

"The huge run-up in government debt has led to patently unsustainable fiscal policies across a number of major countries," he said. "So far, the rest of the world's been willing to finance it, primarily with savings from China and elsewhere, but if investors' confidence is shaken, we might see the interest rates on long-term debt rising, and rising very sharply."

Debt crises are usually associated with developing countries, like Brazil, Argentina or Zimbabwe. But they can affect big, rich economies too, where the scale of global damage can be much greater.

"Look at California," Mr. Rogoff said. "It's incredibly rich, but Californians want a lot of services but don't feel like taxing themselves to pay for them. You can be incredibly rich and still go bankrupt."

The depth and breadth of the pain unleashed by the recent housing bust have led political leaders and central bankers to reconsider their duties to pre-empt, rather than just respond to, potential bubbles, and the same is true with the potential bubbles that economists foresee today.

China has started to tighten monetary policy to rein in the hype surrounding its equities. Politicians in the United States, while torn over the means, are discussing ways to bring the deficit until control.

The Group of 20, at its coming meeting in Pittsburgh, is expected to address ways to calm financial frenzies. The solution may involve additional regulation, guidelines for financial compensation and possibly requirements for more market transparency so that, at least in theory, investors can better judge what they are taking on.

But however stringent such new regulations may be, economists say, they cannot completely defeat human nature. Investors will continue to be hypnotized by get-rich-quick deals, seeking investments that magically double, double without toil or trouble.

"Ultimately, bubbles are a human phenomenon," said Robert Shiller, a Yale economics professor and Cassandra of the current crisis. "People just get a little crazy."