

# Hot Air

by Phillip W. Weiss

The existence of a network of stock exchanges with capitalization in excess of \$69,000,000,000,000<sup>1</sup> gives cause to ask the question: What is the source of all this capital? If capital is an asset, then \$69T of this asset should be more than enough to pay for everything consumed on this planet. Yet, the opposite is the case. The world is enmeshed in debt and war. I know that because the mass media reports it. The captains of finance must snicker when they hear politicians bickering over the public debt. To them it must seem so petty. What is a few billions of dollars of debt here and there when compared to all the capital out there?

From time to time the mass media issues alarmist reports of impending financial doom. Their purpose is to prep the public into thinking austerity, so when benefits are reduced and the money supply devalued, they will accept the argument that it is because we are strapped for money. Meanwhile, there's \$69T of capital out there, being traded, but probably not be taxed. All this capital is like a big balloon. It's being pumped up by hot air, per M-M (note: no commodity). It seems that no THING is being traded. Yet that is not the case.

A security represents an investment in a company. If the company performs well, the value of the security goes up; and if the company performs poorly, the value of the security goes down. It's a gamble producing winners and losers. Nobody wants to be the loser. Now, a security is a tradable financial instrument. It can be sold at a profit or at a loss. To finance the purchase, money

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<sup>1</sup> The Money Project. *money.visualcapitalist.com* – online

is borrowed. If the price of the security remains high, then all loans financing the purchase of the security are covered. But if the price of the security goes down, then all loans financing the purchase of that security are placed in jeopardy. That is an outcome that must be avoided. Hence, when the market gets shaky, procedures have been devised to keep the market propped up. This entails the injection of funds from outside sources. This is known as a bailout. This distorts the market, heats it up, forces third-parties to bear costs, but staves off collapse, which would be catastrophic. Investors are re-assured; panic is forestalled.

The goal of all this is to maintain public confidence in the market and keep investors investing. Money is to be made, not from the company itself, which pays out returns in the form of dividends, but from the buying and selling of the security, ownership of which can be transferred. The hope is that the price of the security will continue to go up. This leads to the balloon effect.

Of course, all things created by humans are fallible and subject to failure. That includes the stock market. The stock market is huge and imposing but brittle. It is money divorced from productivity. All it takes is one puncture and the balloon will deflate into a shriveled piece of junk. Somewhere there are institutions that are holding trillions of dollars-worth of notes that eventually will come due. If these note holders are not desperate for money, everything will be fine. Redeeming the debt can be deferred. Nobody wants to be the first to cause that balloon to burst. But if an emergency arises – a war, a famine, an invasion from outer space, ANYTHING – that produces an urgent need for money FAST, then that \$69T of capital will become 69 CENTS worth of capital faster than the

blink of an eye. And that's because that \$69T of capital is backed up by \$69T of debt. If that was not the case, and the \$69T of capital was backed up by real production, then there would be full, 100 percent employment, no street people, no debt, no wars, no economic inequalities, no poverty, and truly free and open trade.

But it is much easier, and far less risky to keep investing money in what is known and trusted (maybe that is a bit of an overstatement), then to invest directly in productive operations that may not pay off. A financial instrument such as a security represents equity, but it does not necessarily translate into increased productivity. It is all about speculation. Here is a hypothetical example. A woman, Ms. A, loves horses and watching them race. She purchases a 5 percent share in a race horse. The share costs \$1,500. She finances this purchase by borrowing \$1,000 from her bank at 5 percent interest compounded monthly, repayable in one year. The remaining \$500 balance she pays from out of her own pocket. Ms. A is now a part owner of a race horse whom she loves. For her, the purchase is personal. A year passes and the loan is now due. The bank is demanding payment of the loan. So far the horse has failed to produce income. Ms. A now owes \$1,051.20 ( $1000 (1 + .05/12)^{12} = 1000(1+.00417)^{12} = 1000 \times 1.0512 = \$1,051.20$ ). Either she refinances or sells her share. The bank refuses to refinance the loan because so far the horse has produced no income. So, Ms. A reluctantly decides to sell her share. She goes to the Race Horse Syndicate Exchange where she contracts with a horse agent to broker a deal.

The agent finds a buyer, Mr. P; the selling price is \$1,551.20 plus a 10 percent broker's commission payable by the buyer. Hence, the final purchase price is \$1,706.32. The deal is made. Ms. A pays off her debt, sheds a few tears and is no longer in the picture. In one year the value of the share in the horse has increased by 13.75 percent. The new shareholder, Mr. P, knows nothing about horses; his motivation to purchase is strictly speculative. Relying on the broker's assurances that the horse has excellent income earning potential, Mr. P made the purchase. Mr. P understands that there is risk involved but believes that the horse will earn him money. He has never seen the horse. In fact, he doesn't even like horses. Still, for him it's a good investment. Of course, he borrowed money to make the purchase, increasing the bubble. As for the horse, its status as a non-winner remains unchanged, including its potential to be a winner.

Despite all the maneuvering, we must not be too critical of those in charge of the financial institutions. They are monitoring the condition of the balloon and want to do everything possible to keep it inflated. They know that if the balloon bursts, then the day of reckoning will arrive, and it will not be pleasant. Granted that this is a discussion about finance, not religion, yet in this context the use of apocalyptic rhetoric is appropriate. If the financial capital industry crashed today, the effect would be beyond normal calculation. It would be the 1929 Crash times 1,000-plus, multiplied exponentially or  $C = X (1,000)^n$  (C= crash, X = 1929 crash, n = exponent, value infinity). Such cataclysmic events have happened before, but on a relatively much smaller scale, and even then, the havoc they caused was

almost beyond measure, e.g., Panic of 1857<sup>2</sup>; Panic of 1907<sup>3</sup>; the 1929 Stock Market Crash<sup>4</sup>. We are still dealing with the consequences of the 1929 Crash, which destabilized the world's finances and set up the conditions that led to war. And that occurred when the NYSE was "only" about 1/1000<sup>th</sup> the size of what it is today.

One can argue that safeguards are in place to forestall such a dismal event. That is true. Just like there were safeguards in place to peacefully resolve disputes after World War One, and safeguards in place today to resolve labor-management disputes, prevent wars, foster peace, bring factions together, promote racial harmony, etc. Keeping the hot air inside a heated balloon with is easier said than done. As the heat is applied to the balloon and the pressure inside the balloon continues to build, at some point the balloon will rupture, no matter how firmly tied the knot. When that happens, it produces a mess and the need to create a new balloon.

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<sup>2</sup> James L. Huston. *The Panic of 1857 and the Coming of the Civil War*. Baton Rouge: Louisiana State University Press, 1987

<sup>3</sup> Robert F. Bruner; Carr, Sean D. *The Panic of 1907: Lessons Learned from the Market's Perfect Storm*. Hoboken, New Jersey: John Wiley & Sons, 2007

<sup>4</sup> John Kenneth Galbraith. *The Great Crash, 1929*. Boston: Houghton Mifflin. 1954