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A pathological flow of funds

Foreign money has rushed in for borrowers, who throw it into debt refinancing or speculation.

The body is bloated while the muscles waste away: this is the proper medical description of the economy under Federal Reserve Board Chairman Paul Volcker's regime. By setting interest rates high, only those industrial firms or investment outlets promising a rate of return greater than the prime lending rate—now 20 percent—can obtain funds. Yet because of this very policy, money has come flooding into the United States from abroad. In the first half of 1981, corporations obtained a record $69 billion in external sources of funds, including funds obtained from stock issues, bonds, and bank borrowings. Taxable and tax-exempt corporate bonds sold by nonfinancial U.S. corporations in the first *six months of 1981*, at $25.6 billion, is 70 percent of the total of all such bonds issued for the *entire year of 1980*, and 1980's level was the highest level of corporate bonds sold in U.S. history.

The value of new stock issues for the first half year of 1981, at $11.6 billion, is greater than the total figure of stock issuance for any year in the 1970s. Corporate short- and medium-term bank borrowings grew at a hefty rate. Much of this financing activity drew on funds supplied from abroad. The higher yields offered on U.S. paper attracted at minimum an influx of $40 to $50 billion into the United States in the first half of 1981. A sizeable portion also found its way into real-estate speculation, currency arbitrage, and other speculative repositories.

All in all, thanks in large part to the ocean of foreign money sweeping in, the United States was rife with funds. But these record amounts of funds did not find their way into the productive sectors of U.S. industry and agriculture. Instead, they merely lubricated the growing illiquidity of U.S. corporations.

Two ratios exemplify the worsening of liquidity. In 1980, the ratio of corporate liquid assets (cash and Treasury and other securities that can be immediately turned into cash) to short-term debt stood at 0.67. This meant that in times of a crisis, a corporation could cover 67 cents on each dollar of its debts out of its liquid assets pool. By comparison, in 1945, the liquid assets to short-term debt—or liquidity—ratio, was 4.84, or six times what it was in 1980. However, by the end of the first quarter of 1981, the short-term liquidity ratio had fallen to 0.61: a drop of nearly 10 percent from the 1980 level in just one quarter!

In fact, the level of corporate liquid assets fell from an average of $193.2 billion for 1980 to $187.7 billion during the first quarter of 1981.

What happened is that more and more corporate funds are going into paying off the escalating interest payment on outstanding debt. The ratio of interest paid on corporate debt to gross corporate internal funds for 1980 averaged 58.5 percent. This means that the amount that nonfinancial U.S. corporations disburse solely on payment of interest on outstanding debt in the course of 1980 is equal to 58.5 percent of the amount they spend on corporate capital spending. But, by the end of the first quarter of 1981, the ratio of interest paid on corporate debt to gross corporate internal funds jumped to 63.4 percent. The absolute amount of interest debt payment corporations pay jumped from a level of $115.29 for 1980 to $138.85 billion on an annualized basis, by the end of the first quarter of 1981.

More and more money is passing through the U.S. economy, and yet the once-healthy organs of the economy barely see the money for more than a few days before it passes out through them in the form of debt service to the banks.

Moreover, on top of this, nonfinancial corporations also spent $35 billion in the first six months of 1981, and $9 billion in the five subsequent weeks on corporate takeovers. The nonproductive and inflationary activities of debt refinancing and corporate takeover financing, consumed at minimum 60 percent of externally obtained funds by U.S. corporations.

Consider this: the velocity of money in the United States is such that the entire $100 billion in New York city clearing house banks checking accounts turns over every four hours, and the banks clear $1 trillion a week.

The economy is flush with cash, yet none of it is ingested into the industrial sector to aid the physical economy.

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