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IIRE Working Paper Number 38:

The power of financial capital and its links with productive capital

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The power of financial capital and its links with productive capital

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The aim of this Seminar is to share and consolidate as far as possible a broad common understanding of the situation of the world capitalist economy and the perspectives for the working class largo sensu and the exploited.

This is why I will start my talk by building some bridges with Michael’s presentation.

I. Bridges with Michael’s presentation

I will peg part of my discussion on Michael’s presentation on his diagram of the profit cycle. I will also take the law of the tendency for the fall in the rate of profit as a central analytical thread. But in a way which focuses heavily on the play of the counteracting factors, both during the period during which their effects are perceptible (possibly measurable) and at the time when they have so weakened that capital’s continuous search for offsets give little results and the fall prevails.

The considerations from which I take my cue in analyzing the world crisis include an important observation by Paul Mattick: “if the ultimate reason for every crisis is capitalism itself, each particular crisis differs from its predecessors just because of the continuous transformation of world market relations and of the structure of global capital. Under these conditions neither the crises themselves nor their duration and gravity can be determined in advance”. He adds that the “crisis cannot be reduced to purely economic events, although it arises ‘purely economically’, that is, from the social relations of production clothed in economic forms. The international competitive struggle, fought also by political and military means, influences economic development, just as this in turn gives rise to the various forms of competition. Thus every real crisis can only be understood in connection with social development as a whole”1.

Turning first to the very end of Michael’s presentation, the on-going world crisis ended the longest unbroken phase of accumulation in the history of capitalism. Over sixty years if the end of the Second World War is taken as the starting point; a little over forty years if 1976, which saw the end of the first postwar world recession, is chosen. In my view this phase corresponds broadly to the notion of “long waves of capitalist development” in the wide sense used by Trotsky and not to a Kondratieff cycle. Today I see no endogenous mechanism announcing the start of a new cycle. For the time being at least, exogenous factors creating the conditions for a new long wave can only be the object of intellectual speculation.

The idea of “longest unbroken phase of accumulation” calls for an important caveat. It only applies fully to the old industrialized countries. If one takes their growth rates of GDP and investment as a proxies one sees that the pace of accumulation in the advanced capitalist economies slowed continually over the period before breaking radically in 2009. Michael

1 Mattick, 1981.
shows that this is paralleled for the US by the behaviour of the rate of profit. If GDP growth and investment figures for the world economy are considered then towards the end of the period and into the crisis the story is different. On account of China and the large economies for which it serves as a locomotive, 2008-2010 is just an indent.

“Capital as a whole”

This means that we must really attempt, however difficult it is and however imperfect the figures and so the calculations, “to take the world economy not as a sum of national parts”\(^2\) but as a hierarchically differentiated totality\(^3\). “The establishment of the world market” contained “in the very concept of capital” as put by Marx, is achieved. China’s entry into WTO represented the final step.

This makes the ongoing crisis a world crisis not simply a world crisis in the sense of that of 1929 but that of “capital as a whole”. Neither the profit cycle nor the identification of the counteracting factors to the fall in the rate of profit and the assessment of their effectiveness can be analysed any longer for a single economy however important and have to be approached for capital as a whole. No single economy alone can lift either itself or global capitalism out of the crisis in the way the US economy could in the 1940s in the context of the Second World War and its aftermath.

In order for a long term process of accumulation as distinct from temporary recovery to begin again the rate of profit will have been reestablished for capital as a whole.

The first requirement for accumulation as distinct from recovery to begin again is that the destruction of productive capacity and interest-bearing capital and fictitious capital must have taken place on a sufficient scale throughout the world economy. This is what the combined effects of the 1929 crisis and the Second World War did on a massive scale clearing the decks for the long term accumulation just talked about.

Well into the seventh year of the world economic and financial crisis this is clearly not the case today. There has been some restructuring but no clearing of decks for capital as a whole. While the destruction of productive capacity went forward in the US in 2009 and is still proceeding in Europe, it has not taken place either in China, South-East Asia or India, nor except in certain industries to accommodate for Chines imports in Brazil.

With respect to fictitious capital the situation today is that of a totally derisory destruction with consequences both in the form 1) of the mass of surplus value appropriated through the servicing of public debt and then retained in the sphere of financial markets and devoted to speculation and 2) in the havoc created by fictitious capital movements from one market to another, some type of assets to others.

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\(^2\) Trotsky, Preface to The Permanent Revolution, 1931
\(^3\) A notion I have developed for the approaching the analysis of world economy on the basis on remarks by Marx in a passage of the Grundrisse on the method of political economy: “The conclusion we reach is not that production, distribution, exchange and consumption are identical, but that they all form moments of a totality, distinctions within a unity. (…..) Mutual interaction takes place between the different moments. This is the case with every organic whole.”
The destructive functions of economic and financial crisis have been stifled or rather made to play out over a very long period. We should pause a moment and consider the implications of this. I interpret the fact that governments intervened so spectacularly in October 2008, agreeing during a few months in the G20 to coordinate policies as expressing something about power relationships between major states, the political consequences of the very high degree of economic interdependence between them. I think it also says something about the balances of class forces. Globally they are very strongly weighted in favour of capital and against labour but in a very differentiated way. In the US perhaps not weighted in favour of capital to the extent that the bourgeoisie could afford mass unemployment on the scale of the 1930s. In China the policies of the CCP apparatus are dictated by its recognition of the latent power of working class and the fear of provoking its coordinate action at a national level. It is only in Europe since 2010 that the bourgeoisie have felt strong enough to apply Shock strategy and attack the working class frontally very brutally.

The second requirement for accumulation as distinct from recovery to begin again is that capital as a whole succeeds in reactivating the counteracting tendencies. Here my assessment is that if one considers the list made by Marx namely, (1) the increase in the degree of exploitation of labor, (2) the depression of wages below the value of labor power, (3) relative overpopulation, (4) the cheapening of elements of constant capital and (5) foreign trade, the situation is one where since 2001 capital as a whole has amply resorted to (1) and (2) and enjoyed the existence of (3); where with regards to (4) fierce competition for depleting mineral resources is tendentially increasing the price of the raw materials and energy (e.g. “circulating capital”) components of constant capital; and where (5) is not open to capital as a whole but only to certain countries and highly internationalized corporations. The hypothesis I submit is that capital had fired a large part of its munitions during the years it fought to put off the crisis.

I will end these remarks by stressing that capital as a whole has no “new frontier”, nor any new fields or “provinces” of accumulation (Rosa Luxemburg). Technological investments, with the partial exception of China, are highly focused on labour saving innovations and geared to surveillance and control. They cannot lift the world economy out of slow growth and very high global unemployment.

Finally the ecological dimensions must be introduced. As it runs its course in the years ahead, the global economic and financial crisis will increasingly be marked by what Marx summed up very briefly in the last sentence of chapter 15 of volume I of Capital that “capitalist production only develops the techniques and the degree of combination of the social processes of production by simultaneously undermining the original sources of all wealth — the soil and the worker”. The increasingly by marked by what Marx summed up very briefly increasingly interface with “local” expressions of the infinitely more portentous crisis of global climate change and its consequences in terms of climate-driven migrations and climate wars. On account of the ageing of the park of nuclear reactors the likelihood of nuclear disasters on the scale of Fukushima, along with reactions similar to those of Tepco and the Japanese

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4 This is a position which I share with Baronian (2013, p.190).
government, is high. As consequence and cause of these numerous dimensions of crisis, political tensions and/or out-right conflict of varying intensity between States of different size and military status and of civil wars fomented from outside will constantly affect different parts of the world.

II. Finance capital today

The organizers of the Seminar have entitled my presentation “the power of financial capital and its links with productive capital”. Differences and opposition between these two forms could be read (or rather over-read) in my work at one time. They certainly do not correspond to my understanding today.

My analysis departs from the predominant current approach of the Left, including many Marxists, which tends to equate “financial capital”, as it is named, principally with financial corporations, e.g. with banking and insurance conglomerates and hedge funds. I argue that finance capital – Hilferding’s term that I propose to keep for reasons of analytical clarity and not simply that of Marxist “orthodoxy” – refers to something more, and infinitely more formidable than capital operating in financial markets. The term “finance qua finance” will be used for operations or institutional constructs specific to banks and hedge funds.

In the contemporary conditions of globalisation finance capital is the outcome of an unceasing process of centralisation and concentration of industrial, banking and merchant capital alike and of their intermeshing. Contemporary finance capital is in combination “productive capital” lodged in industrial corporations, all of them transnational corporations (TNCs), “money capital” centralised in very large and powerful financial conglomerates and merchant and commercial capital embodied in the conglomerates operating in both in commodities proper (Cargill, Dreyfus) and in final commercialisation (Wal-Mart, Carrefour).

1. Capital centralisation and concentration and oligopoly

The pressure of mainstream economics and for those in academia the radical change in teaching curricula and in the type of research required for tenure, coupled with the effects of deregulation on anti-trust surveillance in countries like the US where it led to a large amount of research in the after WWII period has led to a retreat of work on monopoly and oligopoly and the configuration of industrial structures. Despite their erroneous theory of surplus, Baran and Sweezy’s Monopoly Capital remains a landmark. Globalisation and financialisation have accentuated the hierarchical character of inter-corporate relationships and the degree of differentiation between firms. The degree of internationalisation and productive and predatory sourcing creates a major divide between the small number of large or very big corporations quoted on stock markets (bourses) and all the others. The independence of firms from banks or on the contrary their dependence on and so their subordination to them, is another.

In the advanced capitalist countries poles of the world economic system, at the summit of the corporate hierarchy among the very large financial and non-financial corporations this intermeshing involves relationships between equals. There is no pre-eminence of banks as in Hilferding because from the late 1970s on large corporations began to finance their
investments through the issuance of corporate bonds and accessorially of shares. They severed their dependence on banks before becoming more and more self-sufficient financially and today “awash with cash”. In the US banks are important shareholders of most non-financial corporations but the executives of Goldman Sachs, JP Morgan are on an equal footing with those of Exxon, Wal-Mart and General Motors. Maximising shareholder value is their common creed and no banker is going to meddle with management.

Once one leaves the inner circle of finance capital, the pre-eminence of banks and funds and their direct intervention in management decisions increase. Within the US productive system as corporations become smaller shareholder activism increases. The smaller corporations are more likely than larger one to be object of leveraged buy-outs (LBOs) by equity capital funds – the most pursed form of predatory capital. More broadly in all industrialised capitalist countries one finds the total dependence of small firms on bank funding and the vetting of their projects by bank staff.

When one moves to the periphery of the world system in its dimension of financial globalisation, notably to the US’s “back-yard” in Latin America, the weight of finance qua finance does become very strong because as inflowing financial investment interfaces and merges with domestic capital accumulation based on landowning and natural resource endowments. The scale of equity fund raiding on foreign corporations and of cross-frontier LBOs as a specific form of merger and acquisition (M&A) have become large enough for UNCTAD to single them out in its annual survey of FDI.5

2. Financial accumulation and today’s pervasive traits of interest-bearing rentier capital

In Part V of volume III of Capital, Marx makes several remarks concerning “the accumulation of capital in the form of loanable money capital” as distinct from and not coinciding “with actual accumulation, i.e., the expansion of the reproduction process”. This stems from the cyclical features of accumulation, but also from the basic reason is that “the transformation of money into loanable money capital is a much simpler matter than the transformation of money into productive capital”6.

The extraordinary strength of finance qua finance rests on the fact that the accumulation of capital seeking valorisation as loan capital, e.g. “financial accumulation proper”, goes back to the creation of the Eurodollar market in London, was fed by the servicing of Third World government debt, then by market-based retirement systems (Pension funds) and then independently of genuine working class savings by the play of declining marginal propensity to consume of high income brackets despite all that Duménil and Levy would have to believe and now finally more than ever by the servicing of government debt. Of course non-reinvested profits also feed “financial accumulation proper”, but the gigantic global “plethora of capital”7 has broader systemic foundations with government debt now as its core. The dimensions of this plethora cannot be attributed simply to the fall in the rate of profit. The

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5 See UNCTAD, World Investment Report 2013, pp.13-14, table 1.2 and figure 1.5.
latter of course accentuates the dearth of surplus value faced by the huge amount of capital, productive and fictitious wanting to maximize the returns on their investment.

For the greater part Marxist analyses of interest-bearing capital have focused on its function as loan capital operating in the sphere of the creation and allocation of credit. I argue that the channeling in contemporary capitalism of surplus value through government loans and the possession of stock to a common group of highly concentrated financial and non-financial corporations and private high-income bracket asset-holders requires that features of concentrated money capital still treated partly separately by Marx in volume III now be approached in toto.

The traits of interest-bearing capital which must now be taken in combination, include exteriorty vis-à-vis production and social needs in which the total indifference of the human costs of exploitation now extended to indifference of the ecological consequences of limitless accumulation and unrelenting methods of dispossession; the predominance of the viewpoint of “capital as property” over “capital as function”; the generalized recourse to corporate strategies in which the appropriation of already produced surplus-value, or surplus-product, tends to overweigh its creation and a systemic constant reinforcement of a state of things where “the relations of capital assume their most externalised and most fetish-like form”, one in which for those that possess it, “it becomes a property of money to generate value and yield interest, much as it is an attribute of pear-trees to bear pears.” These traits pervade the activities of banks, industrial corporations and concentrated commodity or merchant capital alike. They give Lenin’s chapter on parasitism in Imperialism the Highest Stage of Capitalism the greatest possible actuality.

Every Marxist and indeed heterodox economist is obliged to propose a definition of “financialization”. I see it as an epoch in the history of capitalist development starting in the mid-1980s, inextricably linked to the globalization of capital in its industrial, financial and commodity capital forms, in which the traits of “interest-bearing capital” taken in toto have pervaded the process of capital extended reproduction and accumulation in its entirety. Pari passu, mankind’s relationships with nature are now principally shaped by the parasitism bred by such capital along with the increasingly well-studied facets of financialization in daily life.

3. The financialisation of industrial corporations

The analysis of the financialisation of industrial corporations includes two broad areas: their operations in financial markets and those directed to surplus value production and to its appropriation or rather predatory poaching.

Since the 1960s first US and then all TNCs have become organizations engaged both in the production of value and surplus value and in financial market operations and loans. This is
where the notion of the large corporation as a group rather than a firm or an enterprise is of great importance. In an early study very little read by English-speaking economists, Serfati showed that at the level of the holding company, TNCs had all established financial departments making a large range of short term financial market, money market and foreign exchange market operations of non-negligible dimensions. A number possessed at one moment affiliated group banks. In a path-breaking research known by English language readers, Krippner writes that “the increasing dependence of non-financial firms on financial activities as a source of revenue is critical for understanding of these firms. Indeed, the very elusiveness of the control debate reflects the fact that the distinction between the forces acting ‘inside’ and ‘outside’ non-financial corporations is becoming increasingly arbitrary. Non-financial corporations are beginning to resembling financial corporations – in some cases, closely – and we need to take this insight to our studies of corporate behaviour” (author’s stress). One of her findings is that the ratio of portfolio income – interest, dividends and capital-market-investment gains – to cash flows which she uses as her indicator of financialization, grew from 20% in 1980 to 60% in 2001.

The pervasive parasitism of contemporary finance capital also characterises the present forms of corporate organisation, which now focus less on the exploitation of labour intra-muros that on the predatory appropriation of surplus value from weaker firms permitted by monopolistic and monopsonic positions along “global value chains” (GVCs). The lengthy chapters devoted by UNCTAD in 2011 to “non-equity modes of international production” (NEMs) as it names them and then again in 2013 to GVCs provide invaluable detailed information on the extraordinary intensity of exploitation built on monopsonic power now taking place under corporate management operating on a global level.

UNCTAD does not attempt to give a precise definition of NEMs, simply saying that they “include contract manufacturing, services outsourcing, contract farming, franchising, licensing, management contracts and other types of contractual relationships through which TNCs coordinate activities in their global value chains and influence the management of host-country firms without owning an equity stake (e.g. putting up capital) in those firms”. According to UNCTAD in the industries where they are used the most their growth is now faster than that of FDI proper. This is the case in electronics where major industrial groups resorting to NEMs include Dell, Hewlett Packard and Apple. This growth “is driven by a number of key advantages for TNCs: (1) the relatively low upfront capital expenditures required and the limited working capital needed for operation; (2) reduced risk exposure; (3) flexibility in adapting to changes in the business cycle and in demand; and (4) as a basis for externalizing non-core activities that can often be carried out at lower cost by other operators”. To Marxists these “advantages” have a familiar ring. The first is recognisable as

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10 Serfati 1996.
12 The term was first used by Gereffi (1994) on research on the large retailers, Wal-Mart, Carrefour and their like. He identified them as having succeeded in organising far-spread “buyer-driven global commodity chains” characterised by very strong predatory appropriation of value. Research led by Gereffi continues to be one of the main sources of case study data used by UNCTAD World Investment Reports (2011 and 2013).
one of the factors counteracting the tendency of the fall in the rate of profit discussed above. The second and third concern the shifting of risk on subcontractors and component suppliers and the fourth is just a way of saying that the principal firm is using “other operators” to increase absolute surplus value that it will appropriate.

III. Fictitious capital

The question of fictitious capital is inextricably tied up today with of the most contentious issues in the analysis of the financial system, namely the sources and nature of financial profits, in particular those of banks. It is best to clarify this a little before plunging into the analysis of the contemporary forms of fictitious capital.

Here I will just treat the question for banking and trading in asset markets in financial centers. Speculation on food products and basic material inputs to production pertain to a combination, generally specific to each market and political situation of imperialist relationship and of relative strength of oligopoly and monopsony. Eric Toussaint has just written a substantial note touching on this.

1. Financial profits

Among English-speaking Marxists Lapavistas and his colleagues at SOAS have been particularly active in the debate on financial profits, but there has also been a fair amount of discussion on this in Brazil in which Rosa Marques has been involved and which she may talk about in her presentation.

The first point concerns the nature of banking revenues other than interest from loans, often named “non-interest” revenues. Profits derived from fees and commissions have continually grown. They include inter alia forex and investment-banking services to corporations, brokerage, wealth management trading and the management of mutual and insurance-funds for retail bank clients. In relation to the appropriation of value and surplus commissions and fees fall under the heading of interest. The term “non-interest” is not valid in the perspective of the Marxist theory of surplus value production and distribution.

The second point concerns “profits” from speculation. Proprietary trading by the investment bank affiliates of banking conglomerates, now in the form of high-velocity trading, have this purpose. Here one must simply follow Hilferding: “Speculative gains or losses arise only from variations in the current valuations of claims to interest. They are neither profit, nor parts of surplus value (….) They are pure marginal gains. Whereas the capitalist class as a whole appropriates a part of the labour of the proletariat without giving anything in return, speculators gain only from each other. One's loss is the other's gain. 'Les affaires, c'est l'argent des autres.' ”14 The term “fictitious profits” coined by Brazilian economists15

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14 Finance Capital, chap. VIII.
15 Carcanholo and Nakatani, 2007; Sabadini, 2009.
Finally there is the question of the “historically new, exploitative modes of appropriation from the independently secured income of wage-earners” raised by Lapavitsas and dos Santos\textsuperscript{16}, of “significant class-defeats suffered by the working-class movement” I will explain my position when we come to mortgage loans.

2. Bond and shares

Marx sets out the theory of fictitious capital in a chapter bearing on “the component parts of bank capital” (chapter 29 of volume III). He applies the term to government loans and shares. The analysis of starts by the nature of bonds and shares, namely drawing-rights on surplus which are exercised in the first case indirectly through the levying of taxes and the servicing of government debt and in the second more directly through the division of profit between what are named today retained profits and dividends. The term thus serves in a second analytical step to characterize one of the factors affecting capital accumulation. What the possessors of bonds and shares view as “capital”, is not so analyzed from the standpoint of accumulation\textsuperscript{17}. On the contrary, the mass of surplus tapped by bond and stockholders can affect it negatively through different mechanisms.

We cannot follow Marx completely when he refers to government loans as “never (having been) intended to be expended as capital and only by investment as capital could it have been transformed into a self-preserving value”. Since the growth of the “mixed economy” after the Second World War, a part of government loans have been spent in value and surplus value production (state-owned industrial enterprises in mining and manufacturing before their privatization) and more largely and importantly in the close support of the accumulation process (transport, communication systems, R&D). On a much more limited scale, even after extensive privatization, this remains true today, notably for basic research.

The third characteristic of fictitious capital is that of tradable assets with fluctuating prices and the possible advent of conditions on financial markets in which assets become unsalable or salable at very low prices (“fire prices” in today’s jargon). Bond and share trading is based on the capitalization or discounting of anticipated income. Financial markets seem to give government bonds and of stocks an “independent movement which adds weight to the illusion that they constitute real capital alongside of the capital or claim to which they may have title. They become commodities, their prices having a specific movement and being specifically set”. But as Marx points out, “promissory notes (can) become unsalable (and) the illusion of this capital (can) disappear”. The same goes for shares. When financial markets collapse, “wealth vanishes into thin air” as the expression goes.

2. “Traditional” bank credit

Loans to firms for investment are fictitious capital. In principle they represent the most innocuous form of fictitious capital. The production of value and surplus once successfully realized will permit the fictitious capital created by the loan to be wiped out. Excess credit

\textsuperscript{16} Ibid., p.182.

\textsuperscript{17} Capital raised in stock markets “does not exist twice, once as the capital value of titles of ownership (stocks) on the one hand and on the other hand as the actual capital invested, or to be invested, in those enterprises”.

creation and credit bubbles are inherent to the accumulation cycle as well to the profitability of banks. The profitability of banks always depended on the amount of interest appropriated operations and so on the quantity but also the riskiness of the loans they made. Only the very largest could earn in addition commissions through operations such as the search for capital required for the launching of joint-stock corporations or foreign exchange intermediation. From the mid-19th century onwards crises of overproduction were fuelled by what proved every time a posteriori to be excessive credit creation to corporations. Banks were at the heart of the euphoria leading up to crashes and crises.

An important point made by Marx is the interconnection between this form of fictitious capital and the other two. A factor of vulnerability specific to banks is that the greater portion of banking capital is made up of fictitious capital. Stock market crashes would hit banks and trigger off banking crises. He notes that “with the development of interest-bearing capital and the credit system, all capital seems to double itself, and sometimes treble itself, by the various modes in which the same capital, or perhaps even the same claim on a debt, appears in different forms in different hands”\(^\text{18}\). Such processes have taken proportions Marx could only guess very vaguely.

3. Derivatives

In the best of case they are fictitious capital one removed. As put by Norfield: “in the case of bonds or equities, the underlying security’s price is already the capitalised value of expected future revenues – what Marx called ‘fictitious capital’”\(^\text{19}\) (author’s stress). “For options-derivatives, the owner of an option to buy a financial security at a particular price at a set date does not gain any dividend or accrued interest from ownership before the option is exercised because she does not own the security. All that is ‘owned’ is a contract to buy the security at a particular price up to the expiry-date (and the option would not be exercised if the relevant market-price was lower than the option strike-price)”

The frontier between hedging and speculation is impossible to establish. Used to hedge a “put” or a “call-option” represents a form of insurance. The corporation buys enough puts to cover its holdings of the underlying asset so that if there is a serious fall of its price, he has the option of selling them at the strike price. As a speculative instrument it is a bet, a pure gamble. The buyer of a call option purchases it in the hope that the price of the underlying instrument will rise in the future. The seller of the option either expects that it will not, or is willing to give up some of the upside (profit) from a price rise in return for the premium (paid immediately) and retaining the opportunity to make a gain up to the strike price”. Speculation cannot be distinguished from hedging. The Bank of International Settlement (BIS) reports only measures with great difficulty (exemplified by the term “notional”) the scale of derivative trading and captures broad trends in the weight of major forms (currency, interest, commodities, etc.). The scale of derivatives trading is simultaneously an expression of “casino finance” in its purest form and an indicator of the extremely high uncertainty of the environment of financialisation, even for those that played the key role in bringing it about.

\(^{18}\) p. 470.

\(^{19}\) Norfield, 2012, p.106.
4. “Originate-to-distribute” and the new forms of “securities”

The “originate-to-distribute” banking model is one in which banks remove loans from their balance sheets and transfer the credit associated risk to other financial corporations through securitization, e.g. transforming them into negotiable assets. While “traditional loans” appear on the asset side of banks’ balance sheets, securitized loans are put off the balance sheet. They are sold to another bank or fund which is free in turn to sell the assets to yet another financial investor. The scope for leverage is qualitatively increased and so is the amount of fictitious capital in ever more vulnerable forms seeking to make profits through trading.

In the US collection of data started in 1980 for mortgage-backed securities (MBS) and in 1985 for asset-backed securities (ABS) backed by auto loans and credit cards. 1991 and then 2005 were accelerating points in the growth of private-label MBSs. ABSs only reached significant levels in the late 1990s. As for the annual volume of total collateralized debt obligations (CDOs) before 2003 it rarely surpassed $20 billion. Then loan securitization grew rapidly, total annual issuance surpassing $180 billion in 2007. This increase first reflected the extension of the “originate to distribute” model beyond banks and the development of massive issuance and selling of mortgage loans by unregulated financial firms linked to housing and real estate. Then the issuance, opaque packaging and selling and reselling of assets exploded. A very particular system of asset circulation took off with CDOs as the central asset: “CDOs can be viewed as re-securitised securities. Once the pool of ABS and MBS were pooled, these then could be tranched and CDO securities could be issued via special purpose vehicles (SPVs) with varying risk-return and maturity profiles. Following on from this, SPVs could then construct portfolios comprising an array of CDOs and they could issue instruments backed by these portfolios of further CDOs – these are known as CDO-squared. In theory the process could go on so long as investors had confidence in the collateral backing the securities”. This is what I named in October 2007 “fictitious capital to the nth degree” of which the expression “CDO-squared” is an unwitting expression. The “profits” arising from trading such assets are truly “fictitious profits”.

5. Shadow banking

The closest to an official definition of shadow banking is that given by the Financial Stability Board (set up on the London G20 April 2009 Summit). It is that of “credit intermediation
involving entities and activities outside the regular banking system”\textsuperscript{24}. These entities included financial companies (notably non-bank mortgage lenders offering subprime mortgage), so-called special purpose vehicles (SPV) or entities (SPE) established first by investment banks and hedge funds by then also by commercial banks. Shadow banking is now seen as having taken off in the 1990s, but recognition of the existence of a parallel system is recent. It “started to be used widely at the onset of the financial crisis, reflecting an increased recognition of the importance of entities and activities structured outside the regular banking system that perform bank-like functions”. The issue is what the perimeters of the “regular banking system” are, notably with respect to “commercial banks”. An early academic study defines the shadow banking system, as “a set of institutions which operate as banks without being banks, raising resources in the short term, operating with very high leverage and investing in long-term and illiquid assets. Unlike banks, however, these institutions were loosely regulated and supervised, they did not have reserves of capital, they had no access to deposit insurance, to the rediscount operations or to the last resort credit lines of central banks”\textsuperscript{25}. Through the setting up of affiliates with these characteristics “proper banks” were inside the system. In November 2008 Citibank would not have had to be rescued with TARP funds if this had not been the case.

Investments banks and hedge funds were at the heart of the 2008 crisis. Investments banks played a key role in the shadow banking system as suppliers of liquidity to other participants the most important of which were hedge funds. The rapid growth of hedge funds in the years 2000 is an indicator of the insufficient flow of value and surplus experienced by the ever increasing growing mass of interest-bearing capital looking for returns. In the case of Pension funds managers were under pressure to devise forms of “investment” that amount to redistributions of already centralized value and surplus and set up highly speculative affiliates. Couchedin non-Marxist language this point is stressed by Aglietta: “Because of the important fall in stock markets in the wake of the 2001 bursting of the Internet bubble and the fall in long term interest rates, institutional investors looked for other sources with higher returns”\textsuperscript{26}. This was paralleled by the setting up of hedge funds by wealthy individuals.

The name of the game of the very particular system of asset circulation just described is that of being able to meet “margin calls” and not “left holding the baby” or, as an ex-tycoon on Wall Street said of being capable to face the situation once “the music has stopped”. Investment banks did not only supply liquidity but in two cases Bear Stearns and Lehmann Brothers they also held the most risky assets as proprietary traders. At a certain point of the collapse of the housing boom and the slow onset of the US recession investor confidence in the collateral backing CDOs collapsed. Banks and hedge funds all rushed to sell their assets at

\textsuperscript{24} Financial Stability Board, 2011, p.1. The Board almost apologizes for using the term: “some authorities or market participants prefer to use other terms such as “market-based financing” instead of “shadow banking”. It is important to note the use of the term “shadow banking” is not intended to cast a pejorative tone on this system of credit intermediation. However, the FSB has chosen to use the term “shadow banking” as this is most commonly employed and, in particular, has been used in the earlier G20 communications.”

\textsuperscript{25} Farhi & Cintra, 2009. In this and following quotes, the authors’ use of the past tense is respected despite the persistence and even the renewed growth of shadow banking.

\textsuperscript{26} Aglietta et al., 2010.
fire-prices. The crisis became systemic to a degree none of the earlier crises of financial globalization had been, even that of 1998.

The available evidence, attempts at estimation by banking authorities and circumstantial evidence collected by financial journalists, is that the shadow banking system has recovered from a temporary set-back and also gone more “underground”. There seems to be scant information about the type of assets traded.

A last word about interest on mortgage and credit cards as being “exploitative modes of appropriation”. They were a very minor component of the revenues of interest-bearing capital and specific to the US. There they were the basis for a financial construct which exploded in 2008. The Liikanen report on European banks gives figures for the UK where the ratio of mortgage and consumer loans to the total assets of financial corporations has fallen to 4%. Last but not least I share Norfield’s argument that their nature is encompassed by the theory of labour value.

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27 “The argument against the notion that finance exploits the working class by taking a share of wages can be put simply. If one source of financial profit is a cut out of workers’ incomes, in interest payments, fees, etc., then there are two alternative implications. Either this implies that workers are receiving a net income below the value of labour power once these deductions are accounted for, or these deductions are part of the value of labour power, paying for the ‘socially necessary’ goods and services, some of which are delivered on credit. In the former case, where such deductions were persistent, this would imply that a lower value of labour-power was in place than otherwise. But, over time, this lower level would become the new norm. In the latter case, if workers are not being paid below the value of labour-power, then the cost of consumer credit, mortgages, etc., is a part of the regular wages that workers are paid. In neither case is there a systematic ‘financial exploitation’ of workers. Instead, the financial profits are a deduction from the profits of productive capitalists”, (author’s emphasis). Norfield blog, Jan. 2014.