FINANCE, ECONOMICS & POLITICS

TONY NORFIELD / AUGUST 2016

The financial system accentuates all the absurdities of capitalism, but it does this in a way that can make finance appear to be *separate* from the capitalist economy, rather than an inevitable outgrowth from it. Almost every observer of capitalism makes a distinction between the 'real' and the 'financial' economy. Even those who would claim to be anti-capitalist often advocate policies to save the capitalist economy from the vagaries of disruptive financial markets.

A division between a 'real' and a 'financial' economy can seem to make sense, especially given the extravagant rewards of financiers who seem to perform no function other than to boost their own incomes and wealth. A closer look at how the capitalist economy works, though, throws a very different light on what is happening. We need to recognise that the global economy is dominated by a small number of countries and their corporations – and that the financial system is a means by which they maintain their privileged status in the world.

Misleading Differences

The problem of making a fundamental distinction between the 'real' economy and the rest of capitalist activity can be made clear by recognising some basic facts. First, capitalism depends on making a profit, not on making 'things', real – physical – or otherwise. Second, all capitalist businesses do financial deals. Companies trade foreign exchange with banks to get the currency they need to buy imports, or to change the export revenues they receive into another currency. Companies borrow short-term funds from banks to help their cashflow before they get paid for their output, or longer-term funds to help finance their investments. They issue bonds or equities on financial markets to borrow money from investors. They use financial derivatives to insure against adverse moves of interest rates or exchange rates that would threaten their profitability.

Above all, companies are operating in a market in which competing effectively does not simply depend upon producing 'things' more cheaply than their rivals. This is clear from mergers and takeovers: a company in a superior financial position usually gains the upper hand during these processes, and it is not necessarily the one with the superior product. In any case, many large companies that seem to produce things consumers want to buy are often in fact just buying the goods from other companies, in other countries, which they often dominate through large-scale purchases and financial muscle. Apple is infamous in this respect, with the China-based factories of Foxconn assembling most of their key products, from iPods to iPhones, largely made from components produced by other companies in the US, South Korea, Germany, the Netherlands, etc.

And there are often overlaps between industry, commerce and financial operations within the same corporation, so financial operations become key to companies and organisations not generally associated with such activity. Take two examples:

Associated British Foods and Facebook. The first has no real brand name, but this multinational food-processing and retailing company owns Primark, the purveyor of cheap clothing made in Asia to grateful Europeans. It also sells Twinings tea and Ryvita, and supplies most of the bread and sugar sold in British supermarkets. ABF is part of the FTSE100 share price index. It is 55 per cent owned by Wittington Investments, which, in turn, is 80 per cent owned by a charitable trust that also owns the Fortnum and Mason and Heals stores. ABF has done many stockmarket takeovers and sales of other companies.

Everyone, by contrast, knows Facebook, and over a billion people worldwide have a Facebook account. But not many are aware of the company's financial operations. In 2012, its shares were floated on the stockmarket – but these were only the *non-voting* shares. So the key founder, Mark Zuckerberg, ended up owning less than a fifth of the company's total shares, but remained in control of nearly 60 per cent of the voting rights, thus having control of the company. And the share flotation valued Facebook at over $200bn, gifting Zuckerberg and some others billions of dollars in financial wealth. The 2012 flotation allowed Facebook to purchase WhatsApp in 2014 for $22bn, of which 'only' $4bn was in cash: the rest was in exchange for Facebook shares.

These cases are not exceptional. Companies that might appear to be far removed from the realm of finance are intimately bound up with it. They may not be the evil 'banksters' of modern-day folklore, but they will not hesitate use the financial system to boost their economic power and take control of society's resources.

Banks and other financial companies are, though, different from those more focused on production or commerce in two respects. Firstly, there is the difference between producing and/or buying/selling on the one hand, and facilitating the related financial-market deals on the other. Even though some companies might perform more than one of these functions, they are economically distinct.

It is also rare for a company that focuses on finance to get involved in production or commerce. The more specifically financial company usually stands outside any production or commercial operations, instead facilitating these companies' deals in the financial markets. It takes a cut from such deals as fees and commissions, or gets interest from loans made to them. Even so-called 'private equity' financiers that take over companies claiming to restore them to capitalist viability are concerned only with making a profit by reselling. They use a company's weak position to force through the takeover deal, often with financial incentives to existing managers. Then they take advantage of favourable tax laws and other chicanery to complete the buy-low/sell-high transaction.

Secondly, capitalist financial companies are also in a different position from the others regarding the exploitation of workers. In the Marxist explanation of the difference, the company producing commodities for sale directly exploits workers, paying them in wages a value less than that they create. This is the source of their profit. The commercial companies, involved in the buying and selling of these commodities, perform a necessary function to enable the circuit of production to continue, and share in the profits produced. Industrial and commercial companies tend to earn a profit related to their advance of capital. But the financial companies are outside this industrial-commercial circuit of commodity production. Although they also derive their revenues from the surplus labour of the productive workers, the financial companies get their revenues in ways that have little direct relationship to this circuit, and will gain interest and other revenues from their financial dealing. All kinds of capitalist companies depend upon the exploitation of productive workers, but they derive profits from this exploitation in different ways.

In the UK and the US, especially, the focus of corporate activity is commerce and finance. Their so-called 'value-added' activities cream off the value that others produce: both in the case of apparently 'productive' companies getting other countries' lowpaid workers to do most of the actual producing, of which results they are the buyers and sellers; and because the UK and the US, as the major centres of financial activity, gain enormous revenues from transactions all over the world.

This is not to deny that many productive activities also take place in these countries. My point, though, is that the US and UK can use their economic privileges in the realm of finance to get significant benefits from what *other countries* have produced.

Financial Operations and the Laws of the Market

The financial markets are powerful because they are a hyped-up version of 'normal' capitalist markets. Anyone who has studied economics knows about the sacred 'laws of supply and demand'. If a producer does not give the market what it wants, at the right price, then bankruptcy looms. Only the fittest survive, ensuring the evolution of the corporate species. What mainstream economics does not like to mention is that the outcome of this trend is the monopolisation of economic activity by a small number of big companies. That would be problematic for enthusiasts of the 'free market'. Still less does such economic theory take into account how much the Darwinian laws are modified by the development of the world economy.

This modification can be tricky to see and is best explained in two steps. First, by looking at the role of financial operations, particularly the creation of credit and financial securities; and then by putting these in the context of power relationships in the world economy.

Most people would agree that banks do not produce anything – at most, they lend money for others to do the producing – but that does not stop banks from 'making money'. They do this in a more literal way than is often understood. Banks do not simply use money from depositors to lend to borrowers, whether individuals or companies: they actually create *new funds* within the banking system by granting loans to borrowers, who then use the funds to buy things.

Bank loans may be taken out as cash from the ATM, but the most important volumes of funds are transferred from one bank account (the borrower's) to another bank account (belonging to the seller of what has been bought) via the interbank payments system. Of the millions of daily transfers, for an individual bank most will tend to cancel out. That is, the money it transfers to other banks will be more or less offset by transfers coming in. If an individual bank still has a shortage of funds (more going out than coming in), then there are usually other banks who have a surplus and are willing to lend it. If not, and the bank still has a shortage of funds, then it can usually get access to what it needs from the relevant central bank – the Bank of England, the US Federal Reserve, etc.

This credit creation can increase expenditures, creating new demand from consumers and investors, so boosting the economy, incomes and jobs. It can appear to be a creation of value out of nothing and, for a time, it is. If you borrow £100,000 from a bank, you do indeed have £100,000 to spend. But when the bank loans and other forms of credit run beyond the ability of the borrowers to pay back, they turn from being assets on which banks get an interest return to being losses that hit bank profits and threaten their viability. So it was that Northern Rock, Royal Bank of Scotland and others faced collapse and had to be rescued by the British state, a similar situation to those of other major banks in other capitalist countries.

Financial securities – bonds, company shares, etc – are another dimension of finance that stretches the relationship between what an economy produces and what wealth appears to be. The price of these securities is a measure of the wealth that the owner could potentially 'cash in', by selling the security or by using it as a means of paying for something else. But this price does not represent the amount of money invested anywhere, or the real value of any asset. Rather, the security's price is determined by quite different factors.

In the case of bonds, for example, the price is determined by the market's view of how attractive the promised future coupon payments look, and the risk of not getting the principal (face value) back when the bond's term matures. The price will be influenced by the levels of interest rates and the changing view of how creditworthy is the company or government that issued the bond. If market interest rates fall, this will tend to raise the price of the bond security, because future payments are discounted at a lower interest rate, and so are worth more now, and vice versa if interest rates rise. There has not suddenly been more or less capital invested anywhere.

In the case of company shares, changes in interest rates have a similar effect on the price: one reason for the rise in equity markets since the crisis lows of 2008 was a drastic reduction in central bank interest rate levels towards zero (now, even *negative* short-term rates in many European countries). Lower interest rates made holding company shares look more attractive to capitalist with money than simply putting the cash in a bank account. The likely future profits for a company also play a part in the setting of share prices: profits have an impact on future dividend payments. This is another peculiarity of financial securities: they have a price *now* based upon economic activity that has not happened yet, and upon profits that do not yet exist – and may never.

Financial activities can seem to break the link between value created and the money or wealth available, especially to those who own financial assets. This accentuates the idiocies of the capitalist market, leading to economic boom and bust. It also leads many to believe that getting access to funds (via bank loans or state spending) is merely a choice made by banks, or is determined by government regulation and spending policy, rather than having much to do with what the economy can ultimately produce.

The banks' ability to create new loans out of thin air endorses such a system of belief. In the years leading up to 2008, banks expanded their lending dramatically compared to the capital invested in them. A 'normal' rate of loans to capital is around 20: in other words, where lending is 20 times the capital invested in the bank. Just ahead of the crisis, this ratio increased to as high as 100 for the most leveraged banks. Their loans were so far in excess of the capital assets of the bank that even a 1 to 2 per cent loss on these loans would have wiped out the bank's capital, making it bust.

This increase in lending was prompted by several factors, including years of what looked like continued economic growth, in which things could only get better, and steadily lower rates of inflation, helped by cheaper imports into richer countries, especially from Asia, and lower levels of central bank interest rates as inflation fell. These lower rates tended to reduce the interest earnings of banks and encouraged a move into more speculative operations, prompting a boom in financial transactions.

The financial boom promoted economic activity, more growth, higher incomes and employment. But, since 2008, there has been a reckoning with what Marx called the 'law of value' – the underlying relationships in the capitalist market. The previous economic promises cannot be met, and belief in economic security is now being shattered.

Origins of the Growth of Finance

Financial dealing has grown dramatically since the 1970s, but this was related to the breakdown of the post-1945 economic institutions, rather than to any sudden desire of capitalists to become financiers. The changing economic strength of the major powers up to the late 1960s undermined the system. Faster productivity growth and increasing competitiveness in Germany and Japan gave them bigger trade surpluses and put upward pressure on the Deutschemark and the Japanese yen, while declining competitiveness in the UK and France led to their currencies devaluing. In 1971, the US put the final nail in the coffin of the Bretton Woods system by suspending the convertibility of the US dollar into gold. Following this, the values of all currencies fluctuated wildly on the market, rather than being managed as before in a relatively fixed exchange rate system.

Turmoil in the financial markets followed. It was fuelled not only by the economic imbalances, volatile interest rates and much higher inflation in all countries, but also by the vast sums of capital that had been invested worldwide. What is often overlooked is that even before many governments lifted controls on the movement of capital from the 1970s, there had already been a boom in foreign investment as capitalists sought more profitable outlets abroad. Alongside this boom, international banking markets had grown to service the financing needs of the big corporations. This led to the growth of the so-called euromarkets for international bank lending and the issuance of bonds. These markets provided a means of financing that fell outside national regulations, and they were also largely exempt from taxation. They offered the corporations access to vast sums of capital on the scale that they needed, but could not easily get, within their home countries – and often at a lower cost.

The market turmoil also prompted the explosion of dealing in financial derivatives from the 1970s. Derivatives are not simply a tool for speculators, little different from betting on which horse is going to win a race, or how many corners there will be in a Premier League football match. Instead, there is a strong economic logic behind the use of financial derivatives – contracts relating to money-market interest rates, bond yields, equity prices and currency values. After all, companies now faced major risks from the ups and downs of interest rates and exchange rates, which affected the cost of their borrowing or the prices at which they would buy or sell products, and thus having a big impact on their profitability. Financial derivatives could be used to hedge against such risks, which meant that these new contracts were added to the existing futures contracts traded on exchanges for commodities such as copper, cotton and pork bellies. New derivatives exchanges were set up in Europe and Japan, adding to those in the US, and there were even more deals done 'over the counter' – directly between banks and their clients. Derivatives were quickly used as a means for further speculation, but their origin was in the real economic risks that capitalist companies faced.

What all this meant was that while governments had previously appeared to be to some extent in control of the markets and to have some leeway in policy decisions, from the 1970s it become clear that the financial markets were outside of anyone's control, and would constrain what any capitalist government could do. In 1976, Prime Minister Callaghan, for example, told the UK Labour Party conference that it was no longer possible to 'spend your way out of recession'. But perhaps the most striking policy change was French president Mitterand's abandonment of 'Keynesianism in one country' in 1981–2. His initial plans to boost public spending as a way to reduce unemployment were followed by monetary and fiscal restraint in 1983. Had he not changed course, France's position in the Exchange Rate Mechanism – a system of currency alignment between key European powers – would have been undermined. Leaving the ERM would have left the running of it even more completely in the hands of France's rival, West Germany, something that French state policy would not accept, as it would have weakened France's bargaining power in setting rules for the system.

Finance, Debt and Privilege

What is often called a 'financial crisis' is the outward expression of a more fundamental problem. Recent decades have seen a boom in financial transactions and the growth of massive loans and debts worldwide. In the 2001–7 period, these helped boost global demand, output and employment, especially in richer countries. However, these developments involved sums that ran well beyond the production of value and profit in the world economy. The bubble burst in 2008, when US mortgage defaults hit financial markets. Yet the global impact of what might otherwise have been a local US problem was due to the fact that financial companies outside the US had also bought large volumes of these securities because they could find few other products that would meet their need for investment returns. Essentially, this pointed to a problem of insufficient capitalist profit versus the huge level of debt and the declining ability to pay off this debt.

Data from a recent report from the Bank for International Settlements, shown in the accompanying table, illustrates that the debt problems have not gone away: indeed they were even worse in 2014 than in 2007, compared to the size of the global economy. In previous crises, there had usually been some reduction in debt levels as banks wrote off bad loans and investors took losses. This time around, governments justifiably feared the collapse of the banking system and the economy if the mechanism of crisis was allowed to run its course. So, in the richer countries at least, they stepped in with emergency rescue measures – the effect of which has been to boost further the total debt mountain. Even in the US, where the government had long since declared the end of the recession, the Federal Reserve took until December 2015 to raise US official interest rates by just 0.25 per cent above the near-zero levels they had previously maintained since 2008.

Debt levels are the highest in richer countries, although since 2007 they have tended to increase by more in poorer countries. For richer countries, the burden of public-sector debt increased especially. This was due both to the recession increasing fiscal deficits and to the state taking on liabilities from private sector banks, as a result of their bad loans to companies and households – although not all of this liability is included in the official figures. The UK, US and the euro area countries have similar levels of total non-financial sector debt, not far below three times GDP; Germany's is much lower, but still high, at just below twice its GDP. Debt ratios in poorer countries tend to be lower as a result of their less 'developed' financial systems, something that reflects their far lower degree of parasitism. But there has been a big increase in debt in China, mainly due to higher borrowing by companies.

Following this explosion of debt, most governments have implemented some form of austerity policy, cutting state spending and raising taxation. However, such austerity has so far been very limited in the richer countries. It is much more brutal in poorer countries, even if they are in the rich man's club, like Greece, Ireland, Portugal and Spain.

Richer countries have more flexibility in their policies than others, not simply because they are have more resources, but also because they have more ability to benefit from the monopolised economic and financial system that works in their favour. Since most international transactions are priced in US dollars, the US gains most in this respect, helped by the US Federal Reserve deciding interest-rate policy and the supply of dollars to the rest of the world. Despite its large trade deficits, the US still funds its vast foreign investments easily, benefiting from the profits they bring.

The dollar's role also allows the US government to isolate whichever country it does not like by cutting it – or anyone who deals with that country – off from the US banking system. This ultimate economic sanction does not even require any bombing, but still has a drastic economic effect, as Iran has found.

Nevertheless, it is often ignored that countries other than the US also make use of their prominent position in the world. Take the UK, the site of the world's biggest international banking centre, home to 40 per cent of the world's currency deals and nearly half of the trading in interest-rate derivatives. Despite running a huge international trade deficit, where imports of goods exceeded exports by more than £120bn in 2014, the UK's net financial services

and insurance revenues covered nearly half of that gap. The British-based banking system managed the funding of the rest. Long after the days of Empire, when the colonies helped finance setting up Britain's welfare state, through forced loans and the provision of commodities to the UK at half the world price, Britain's financial system remains a powerful force in the world economy.

France gives a different example of the privilege of a rich and politically influential country. French banks had by far the largest exposure to Greece at the outbreak of its recent crisis in 2010 – 50 per cent more than German banks, and 40 per cent of the total. This exposure was a result of France's political forays into southern Europe, a means by which it aimed to build a counterweight to German influence. So French politicians, including the celebrated party animal Dominique Strauss-Kahn, former head of the IMF, manoeuvred to get euro-country support for Greece determined by their shares in the European Central Bank. What looked like a technical, neutral policy for euro-area responsibility was really a means of reducing the exposure of French banks and, effectively, the French state. France had a 20 per cent ECB shareholding, half the 40 per cent share of Greek debt it held. So the burden of managing Greek debt was loaded onto other euro members: not only Germany, but more shockingly Italy and Spain – which previously had very little lending to Greece.

Finance, Power, the State and 'Reform'

Faced with such striking facts, many opponents of capitalism rarely focus on its moribund nature and instead advocate reform policies. One example is the demand to 'nationalise banks'. Proponents of nationalisation are aware that, in the wake of the crisis, many capitalist governments have already put some institutions into state ownership, even in the homes of liberal financial regulation, the US and the UK. In the US, this was called putting important financial companies into 'conservatorship' to avoid the politically charged term. In the UK, the term 'nationalisation' was also avoided, and the government made a special effort for the largest affected banks, RBS and Lloyds, to keep a portion of their shares in private hands. However, rather than being embarrassed that the capitalist state upstaged their demands, left proponents of bank nationalisation argue that the state could have forced these banks, and others, to redirect their lending policies to boost domestic industry, investment, employment and the economy in general.

A belief in the benefits of nationalisation is more than simply naïve: it reflects the view that the capitalist state is like a weapon that can be taken from the hands of the capitalists and used against them in favour of the mass of people. So the state, with its laws, institutions, multi-layered backing and means of applying influence and force to support capitalist exploitation can supposedly be redirected in a progressive way, rather than remaining a machine churning out policies that reflect capitalist class power.

Proponents of such a view avoid the key distinction between taking power away from the capitalist class and advocating reform policies within a framework that keeps the capitalist class in place. In the absence of a change in power, reform proposals fail, the policies are junked and there formers are either kicked out of office or, more usually, capitulate to the demands of the market. Worse, such a political stance always has the logic of demanding that *the state* do something for the mass of people, rather than attempting to politically organise people to get what they need. Instead, it is a plaintive call for the *capitalist state* to deliver on its obligations – which it does not have except in the imagination of the reformers.

Financial power in the modern world is not confined to banks, neither is it constrained within national boundaries. Financial securities are issued by and traded by banks, but the securities are issued mainly on behalf of the many industrial and commercial companies that are otherwise seen by many as – relatively – the good guys versus the 'bad bankers'. But all these companies are directly interested in and benefit from the exploitation of workers. Furthermore, the major capitalist corporations operate internationally, backed by their states, and the ones from the powerful countries can use their financial leverage, though mergers with and acquisitions of other companies, to increase their economic power in the world market. And this has little to do with banks: all kinds of financial and non-financial company are involved in the process. One study has showed that just fifty companies, largely based in the major powers, control through cross-shareholdings around 40 per cent of the equity in a total of 43,000 international companies based in 116 countries. Most of these 50 were financial companies, but they were mainly asset managers and insurance companies: only a minority were banks.

The idea that nationalising banks will rectify the capitalist economy, or can be used as a progressive demand, is ludicrous. It is an idea based on a national social-democratic delusion, one that all-too-often becomes political support for the national state 'protecting' the domestic economy against the 'unfair' policies of other countries. Recently in the UK, the loss of steel industry jobs due to a decline in the world market has led to demands from across the political spectrum that the British government take action against cheaper imports of Chinese steel. This makes a defence of jobs and livelihoods dependent upon state action to oppose another country, rather than showing how the job losses result from an outmoded, dysfunctional capitalist system of production. Worse still, the natural opposition that workers have to bearing the consequences of capitalism then becomes a demand for the state to defend the national version of capitalism against other national versions. It is all the more naïve in the UK, when the policy of the British government is to *expand* deals with China, both to finance

UK energy and other infrastructure projects that local capitalists will not take on, and to openup financial transactions with China to boost British imperialism's revenues.

A precondition for control of the banking system possibly being a progressive step is for an anti-capitalist force to take political power to make this work, also known as making a revolution. That is something too many British radicals do not want to mention because its probability has shrunk given very long, sometimes painful, experience. In any case, since when has nationalising anything been 'socialist', except in the capitalist state-oriented outlook of the British Labour Party?

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