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How the state serves finance capital

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The UK and US governments policy of bailing out finance capital appears to have stimulated some recent return to profitability for banks and financial companies. Keith Spencer examines how this policy of handing over money to finance capital worsens the crisis for the working class and stores up greater problems for the capitalist system.

The bail-out policy is based on the belief that the current recession was caused solely by the collapse of the value of the big banks? capital holdings. Although it might seem that the wealth of a bank is the total sum of the money deposited in it by savers, this is a misunderstanding. In reality, a bank holds very little of its deposits because it lends the money out at interest. It is the interest payments that are the source of the bank?s profits. Consequently, how much a bank is worth is measured by the volume of loans it has made. Other things being equal, the more loans it has made the more interest it earns and the greater its ?capital value?.

However, other things are not always equal. If the firms that borrowed the money go bust, then the bank loses its money. Equally, if the bank has lent money out in exchange for various forms of ?securities?, such as company shares or bonds, and their value falls, again, it loses its ?investment?. In such a situation, the bank responds by limiting how much it will lend or, if the situation is really serious, it demands early repayment of all outstanding debts. This is essentially what happened in the ?credit crunch? that began in 2007.

The immediate effect is a slowdown in the economy; firms cannot borrow money to buy raw materials, pay wages, and make investments, etc. This sequence of events itself is well understood by both Marxists and non-Marxists - what is disputed is what causes the sequence and this we have dealt with elsewhere. 1 In this article, we challenge the government?s belief that by simply replacing the banks? loans with new money, which the government has either borrowed or simply printed, will make ?everything equal again? and allow a return to economic growth and prosperity.

Nor is this just a matter of theoretical interest. We can already see how the growing UK debt is causing sharp argument between the Tories and Labour over the scale of the cuts needed after the recession. The question Marxists have to ask is how this policy will affect the accumulation of capital in the wider economy and, crucially for us, what it means for the working class. Below we consider these issues from the standpoint of the Marxist theory of money and finance.

What is money?
Marx called money a ?generalised commodity equivalent?. By this he meant that one commodity had become the measure of value of all commodities. The use of money developed as a result of an increase in trade and exchange. The more commodities that are put onto the market, the greater the need for one commodity act as a measure of exchange between them. So, whereas in a bartering system one bushel of wheat might exchange for one pig or two geese, with the increase in trade, coins became the measure of value for all goods.2 What was crucial was that the coins themselves had their own value, based on the amount of precious metal they contained, the price of which was determined by the labour time taken to extract and smelt the ore and mint the coins.3

With the massive expansion of trade in the modern world came paper money, backed by the gold ownership of the issuing bank. For example, a £5 note could be exchanged for £5 worth of commodities because the issuing bank guaranteed to honour its value. The note itself was only a symbol, but a symbol of a real value for which it could be exchanged. True, where the issuing bank was not recognised, such as in a foreign country, or where the institution had gone broke, then the note was worthless. However, in most circumstances, a note from a respectable bank was ?as good as gold?. Modern measures of money include coins, paper money, cheques and even electronic transactions with the use of credit cards, etc. Capitalism needs a huge array of credit tools to fund its activities hence the massive expansion in electronic forms of money. Nonetheless, at root, these symbols of value only function because buyers and sellers accept that, if necessary, they can be turned into more tangible forms of value.

Money serves three main purposes in a capitalist economy:
? As a measure of value: money measures value and circulates exchange values in the form of prices. As Marx said: ?Money now exists outside and alongside the commodity; its exchange value, the exchange value of all commodities, has achieved an existence independent of the commodity, an existence based in an autonomous material of its own, in a particular commodity.?4
? As a means of circulation: money serves the easy circulation of commodities, so transactions use money not bartering. In effect, money gives form to a commodity?s exchange value - the amount of labour value contained within it.
? As wealth: where money is held by capitalists it acts as a store of wealth. This would commonly be to form a reserve fund for future investment or for the next purchase of raw materials. Moreover, in a recession, hoarding takes place, meaning that money is held back, rather than being risked in investment.

The role of credit and fictitious capital
The massive expansion of credit was both a symptom and cause of the speculative boom and crash that came before the credit crunch.5 Here, we will examine the role of credit in the business cycle, the role of government borrowing and the key differences between fictitious capital and real money.

Credit can take many forms: bills of payment (basically IOUs), shares, bank loans, government bonds (known as ?gilts?) and so on. In the case of credit, money is loaned in exchange for a title to a share of surplus or capital. For example, if someone buys £10,000 of shares, this means they have given a company £10,000 in exchange for the shares, which yield a yearly dividend. The shares are titles to ownership of £10,000 of the company?s capital, but this can only be realised when the owner sells the shares. And, of course, the price of shares can go up or down.

A bank loans £50,000 to a firm. The firm now has £50,000 to invest but has to pay the bank a yearly amount of money in return. The bank, however, will only receive the full £50,000 in, say, 10 years? time; until then, for the bank, the right to the £50,000 is based on ownership of a title to that amount. In addition, to this we also have interest. Interest is the price for a certain amount of money. In the example above, £50,000 may be paid back over 10 years but the bank will take into account depreciation of the currency (i.e. inflation), risk, supply and demand for credit and so on. Interest goes to the bank and is a form of profit - in effect, it is a subtraction from the total profit of all firms in circulation.

Marx said: ?Such papers [forms of credit], however, if in government bonds, are capital only for the buyer, for whom they represent the purchase price or the capital he invested in them. In themselves they are not capital, but merely debt claims. If mortgages, they are mere titles on future ground-rent. And if they are shares of stock, they are mere titles of ownership, which entitle the holder to a share in future surplus value. All of these are not real capital. They do not form constituent parts of capital, nor are they values in themselves.? 6

They are not real capital but fictitious capital. It is the massive expansion of fictitious capital and what Marx calls ?debt claims? that fuels capitalist accumulation. When this happens, there is a huge disequilibrium between the real value of commodities (the monetary equivalent of the amount of labour time it took to produce them) and the nominal prices of the ?titles to ownership?, e.g. the shares.

The destruction of credit and capital
The current global recession has destroyed 45 per cent of all wealth in the world, according to private equity company Blackstone.7 Fortune magazine recently published a survey of the US?s top 500 companies that showed how fictitious capital can be destroyed.8

In 2006, the total profits of Fortune?s top 500 companies came to US$785 billion. In 2008, the figure was just US$98.9

billion, a staggering fall of 87 per cent. Or, to put it another way, ?for every US$1 in profits made in 2006, the top 500 companies made 13 cents last year.?

Some of this loss represented real capital, for example, commodities that could not be sold, factories left to close, and people made unemployed. But a large part of the loss resulted from nominal values finally plunging down to realign with their real value. The greatest damage was done to financial companies: banks, mortgage companies and so on. In 2006, financials in the top 500 made a total profit of US$257 billion (just under a third of total profits of the 500); in 2008, they lost US$213.4 billion. These are the companies that trade in the fictitious capital that is most at risk when nominal values fall to real ones.

During the boom, not only shares but also a variety of sophisticated ?financial securities? took on an independent life of their own where they were subject to their own laws of supply and demand. Buying and selling securities offered much quicker - and much bigger - profits than almost any investment in actual production of goods. However, once the boom became a crash, their ?values? fell sharply. To give some indication of the effect of the rapid decline of fictitious capital on real money capital, Fortune says: ?The US$470 billion swing in profits [among financials between 2006-8] explains almost 70 per cent of the total dollar fall since the heights of 2006?.9

The stages of credit in the capitalist cycle

Why does the value of the forms of fictitious capital rise so dramatically and outstrip the real value of commodities? For this we have to look at how Marx described the role of credit in the three main stages of the business cycle.10

The period of crisis: There is a widespread fall in production and commodities cannot be sold on the market. The contraction in economic activity means that capitalists seek to turn commodities into money capital or wealth, that is, they are hoarding money to safeguard against debts, etc. As Marx said: ?In the crisis, the demand is made that all bills of exchange, securities and commodities shall be simultaneously convertible into bank money, and all this bank money, in turn, into gold.?11 The turn to real money and the lack of demand for credit to invest means that interest rates are low. One positive aspect of a low interest rate is that a greater amount of any surplus is given over to profit because companies are no longer paying high interest rates. Over time, this will help towards the restoration of a higher rate of profit.

The period of recovery: Production and circulation begin to move forward but there is still an abundance of money capital that can be loaned out. Hoards are used to invest and there is an increase in the demand for credit. Interest rates begin to rise but not to the levels encountered at the top of the boom.

The period of boom: The feverish expansion of capital leads to greater demands for credit but the demand always outstrips supply. Interest rates and the prices of credit of fictitious capital (stocks, shares and so on) rise to their highest point. These prices outstrip the real value of commodities. Marx said: ?Credit, likewise a social form of wealth, crowds out money and usurps its place. It is faith in the social character of production, which allows the money-form of products to assume the aspect of something that is only evanescent and ideal, something merely imaginative. But as soon as credit is shaken - and this phase of necessity always appears in the modern industrial cycle - all the real wealth is to be actually and suddenly transformed into money, into gold and silver - a mad demand, which, however, grows necessarily out of the system itself.?12

This is the precursor to a crash.

The role of the state, credit and quantitative easing

As the current crisis took hold last year, finance capital?s exposure to losses on fictitious capital investment was laid bare. Both the UK and US slashed interest rates to historic lows in an attempt to avert a banking crisis and keep money and credit circulating. From October 2008, the US and UK governments both pursued a strategy of handing over real money to shore up failing banks. In the US, Bush?s 2008 Emergency Economic Stabilisation Act provided US$700 billion to buy toxic assets and inject capital into the banking system. The Paulson Plan (as the act was known) gave the government nearly unlimited powers to buy mortgages and other assets. The plan also included US$250 billion to inject funds into banks in exchange for shares etc, which is similar to the Darling/Brown plan.13

In March 2009, President Obama launched the Geithner plan (named after Tim Geithner, Obama?s Treasury Secretary). It provided a fund of US$1 trillion to buy toxic assets (fictitious capital that has lost its value) held by banks by matching one dollar of private money with one of government and of treasury money. It also allowed the government to leverage the money by 600 per cent, that is, to loan out six times the amount that it actually holds. So generous are the terms that the private investor cannot fail, only the taxpayer can. World Bank economist Jeffrey Sachs called it ?a massive transfer of wealth from taxpayers to bank shareholders?, while Nobel prize winner economist Paul Krugman said: ?If asset values go up, investors profit; if they go down, investors walk away.?

To give some idea of the plan?s generosity, the Financial Times explained how a private investor buying US$10 million of mortgage assets would walk away with US$2 million profit even if they proved to be worthless, and US$5 million profit once the government?s loans etc were accounted for.

This is a deal, it seems, where the capitalist cannot lose.14

In the UK, the government announced an unprecedented US$850 billion (£500 billion) to rescue the banking system: £50 billion was injected into the UK banking system as real money in exchange for shares of those participating banks; £200 billion was offered by the Bank of England in short term loans; another £250 billion was to underwrite loans between banks. This has given the government majority holdings in Lloyds Bank and RBS.

The Bank of England also adopted a policy of quantitative easing to increase the supply of money. The Bank of England interest rate is at 0.5 per cent, a rate that would, under normal conditions, encourage firms to borrow money for investment and, thus, stimulate economic growth. However, as Marx pointed out, in a recession, although there is an excess of money capital, the capitalists do not want to convert money capital into, for example, commodity capital or industrial capital through investments. On the contrary, they are determined to turn all other forms of capital into money capital and to hoard it until the good times return.

The UK government, along with the Bank of England, is committed to creating money to counteract the freezing up of circulation. Under quantitative easing, the Bank of England organises a reversed auction, in which the sellers of bonds, gilts and so on compete for the offers of the Bank of England and so drive down price. The Bank of England exchanges these cheap assets for real money, which it creates. The hope is that the banks will then pass on all this extra money capital, at low interest rates, to stimulate growth in the rest of the economy.

Where did this money go?

The Bank of England?s own statistics show that some of the money exchanged for bad assets simply went abroad, there was an outflow of £1,000 billion from the UK or 15 per cent of total foreign deposits.15 The Daily Telegraph claimed that 80 per cent [of the UK bank bail out] was tied up in loans to foreign nationals and companies, bond issues and other investments.?16

In March, the Independent claimed that, through the quantitative easing plan, ?the Bank of England may, possibly inadvertently, be buying up gilts from foreign investors who, according to the latest data, held over £190 billion, or 36 per cent, of UK government debt. If the bank is pumping its new money abroad, it is clearly not going to UK households and businesses, and will not help boost UK demand.?17 The Times also highlighted how the money was being hoarded by other parts of finance capital. It quoted Sir Steve Robson, former second permanent secretary at the Treasury, saying that: ?The bulk of the money has gone to overseas sellers of gilts. It needs to switch purchases to UK corporate bonds and so directly address credit conditions in the market.?18

In the US, one of the biggest benefactors of Bush?s bailout was insurance group AIG. In March, the company was forced to disclose where the money went. Of the US$180 billion of aid in 2008, US$105 billion was paid out to other banks such as Société Générale (US$11.9 billion), Deutsche Bank of Germany (US$11.8 billion) and Barclays (US$8.5 billion). Goldman Sachs received the most with US$12.9 billion, which has no doubt helped its own early return to profitability. (Edward Liddy, the government-installed CEO of AIG, sat on the board of directors of Goldman Sachs until he joined AIG.)

The costs

? The UK schemes cost about a fifth of GDP so far, according to the International Monetary Fund (IMF) in March.
? UK debt as a percentage of GDP has rocketed to about 56.6 per cent (highest since records began in 1974) according to the Guardian19 and would nominally cost about ?£1,600 for every household in Britain at today?s values?. 20
? The borrowing requirement (the amount the state needs to borrow for its budget) is at about 12 per cent of GDP, while only a couple of years ago it was running at between 7-8 per cent.21
? The headline cost of bailing out the US banks (Paulson and Geithner plans) is about US$3 trillion.22
? US net debt stands at about 40 per cent of GDP23 (and total debt is estimated to rise to nearly 100 per cent by 2015).
? The borrowing requirement is estimated to be about 12 per cent of GDP or US$1.8 trillion in 2009 and rising.24

What is clear is that the banks, pensions funds and giant financial companies have used some of this government money to pay off their own debts and hoarded the remainder. If the intention was to restore the economic conditions of 2005-6, at the height of the boom, then government policy has only been successful to the extent that the banks are regaining profitability and top financiers are again awarding themselves huge bonuses.

As far as the ?real economy? is concerned, the recessionary forces that Marx identified have proved far more powerful than the economic theories of governments and central bankers. Moreover, the huge sums borrowed on the money markets (in other words from the world?s richest corporations and individuals) are now added to the national debt and, together with the money that has simply been printed to finance ?quantitative easing?, increase the likelihood of a future drop in the value of money, that is, rising inflation, when the business cycle turns towards growth.

What is the national debt?

Simply, the national debt is the total amount the government owes to its creditors. A state may have borrowed to pursue a war, build a welfare state or, in this case, bail out banks. It borrows to cover the gap between expenditure and revenue from taxation. Every year it must service this debt, that is, pay the creditors their interest. The money the state has borrowed has been consumed; it no longer exists. What the creditor has is a bond that gives him/her a claim on a share of future state taxation, in the form of interest plus the original amount.

But the bond is only a claim on a future amount of state money. It is therefore a form of fictitious capital, which only becomes real when the return is obtained after, say, 10 years. In the interim, the bond may pass through a number of hands, whoever is the owner has a claim on the interest but has to wait the full 10 years before the money is reclaimed. Depending on interest rates and inflation, the real worth of that money may go up or down. This is the basis of the national debt: it is one huge enterprise of credit and fictitious capital.

Marx said: ?The state has to annually pay its creditors a certain amount of interest for the capital borrowed from them. In this case, the creditor cannot recall his investment from his debtor, but can only sell his claim, or his title of ownership. The capital itself has been consumed, i.e. expended by the state. It no longer exists. What the creditor of the state possesses is: 1) the state?s promissory note, amounting to, say, £100; 2) this promissory note gives the creditor a claim upon the annual revenue of the state, that is, the annual tax proceeds, for a certain amount, e.g., £5 or 5 per cent; and 3) the creditor can sell this promissory note of £100 at his discretion to some other person.?25

Marx also here quotes Jean Charles Léonard de Sismondi favourably on the national debt: ?The public fund is nothing but imaginary capital, which represents that portion of the annual revenue, which is set aside to pay the debt. An equivalent amount of capital has been spent; it is this which serves as a denominator for the loan, but it is not this which is represented by the public fund - for the capital no longer exists. New wealth must be created by the work of industry; a portion of this wealth is annually set aside in advance for those who have loaned that wealth which has been spent; this portion is taken by means of taxes from those who produce it, and is given to the creditors of the state, and, according to the customary proportion between capital and interest in the country, an imaginary capital is assumed equivalent to that which could give rise to the annual income which these creditors are to receive.?26

The national debt thus gives rise to a class of state creditors. In the epoch of imperialism this inevitably strengthens finance capital and leads to an ever greater centralisation of wealth. As we have seen, the UK and US government bailouts have hugely increased the national debts by borrowing from those corporations and individuals who have the capacity to lend such sums. But it is the people, above all the working class, which will have to pay the national debt through increased taxation and massive cuts in social welfare spending. The repayments, with interest, will make those corporations and individuals even richer. These cuts and increased taxation will fall disproportionately on the working class but even sections of the capitalist class, such as UK manufacturing, will also be sacrificed for finance capital through denial of funds for bail outs or cancellation of government spending projects. Also bank hoarding means that the banks charge businesses in the UK higher interest rates than official rates, sparking complaints to Chancellor Darling to act.27

Therefore, the bail out of finance capital will, through taxation and more government borrowing, actually suppress the spending of the masses and reduce the amount of profit (through taxation, etc) available to other sections of the capitalist class for investment in the production of commodities. The US and UK governments are, thus, undermining the ability of the capitalists to start a new round of accumulation and emerge from the current recession in a stronger position. Instead, they are banking on US and UK finance capital emerging from it as the two globally dominant powers that can then start anew the siphoning off of the world?s surplus into the balance sheets of companies in New York and London. Then, they hope, some revenue may end up in the US and UK governments? coffers again.

Austerity ahead

The UK government?s visits to the money markets may be necessary to prop up UK finance capital but in the long term it create problems. When the state borrows, it squeezes out its competitors by either taking all the money on offer or by offering better terms on fictitious capital (gilts, shares, bonds, etc) than other capitals. In so doing, it restricts the supply of money and forces up interest rates for other capitalists while simultaneously trying to flood the market with money. The outcome is contradictory, in the current phase it is likely to lead to deflation and only a slow climb out of recession. However, in the longer-term, the quantity of money may increase to such a size that qualitatively it loses its role as a true reflection of value and so leads to rapid hyperinflation.

Furthermore, there is the chance that the UK government?s borrowing becomes such a great proportion of GDP that it can no longer cover the interest payments and defaults. The recent threat of downgrading by ratings agency Standard and Poor?s suggests that the UK government may have to pay more interest for its loans in future, leading to greater taxation and more cuts in services. Worse, the ?toxic assets? that have been bought from the banks in the hope that they may recover at least part of their nominal value, may turn out to be completely worthless. That could force further borrowing and even a government default, leading to a cataclysmic run on sterling and the ruination of the UK economy.

The reluctance of the UK government to publish its spending plans suggests that the attacks will be historic in nature. Irrespective of whether the economy rises out of its recessionary gloom, the unemployed, working poor, disabled, single mothers and working class will face a decade of austerity when the capitalist state, at the service of finance capital, makes the masses pay for bailing out the financiers.

Footnotes

1 See The Credit Crunch - a Marxist Analysis or WP 335, May 2009, both at www.fifthinternational.org [1]
2 See Marx Chapter three of Capital volume one, www.marxists.org/archive/marx/works/ [2] 1867-c1/ch03.htm
3 For the sake of simplicity I am assuming that prices equal value, which Marx does in Volume one of capital. In volume three Marx explains how price differs from value and the importance of this for circulation and production.
4 Marx Grundrisse, The Chapter on Money part two www.marxists.org/archive/ [3] marx/works/1857/grundrisse/ch03.htm
5 See Karl Marx and the Credit Crunch http://www.fifthinternational.org/index.php?id=85,1329,0,0,1,0 [4])

6 Capital vol three Chapter 28. ?Medium of Circulation and Capital; Views of Tooke and Fullarton? www.marxists.org/archive/ [3]
marx/works/1894-c3/ch28.htm
7 See Reutars report at http://www.reuters.com/article/ousiv/idUSTRE52966Z20090310 [5]
8 Fortune 18 May 2009. All references to Fortune?s study are from this issue.
9 Fortune ibid, p82 ibid
10 This next section is derived from Marx?s Capital, volume three, chapter 30 http://www.marxists.org/archive/marx/works/1894-c3/ch30.htm [6] also volume three chapter 28 op cit, unless otherwise stated
11 Marx, Capital volume three, chapter 35 www.marxists.org/archive/marx/works/1894-c3/ch35.htm [7]
12 Marx, ibid
13 Sudeep Reddy (September 28, 2008). ?The Real Costs of the Bailouts?. The Wall Street Journal, http://xrl.in/2rz8 [8]
14 Financial Times, 1 April http://xrl.in/2rz9 [9]
15 Independent 14 march 09, http://xrl.in/2rza [10]
16 Daily Telegraph, 17 January)
17 Independent ibid
18 The Times (7 May, 2009)
19 See Guardian, http://xrl.in/2rzb [11]
20 See Guardian, http://xrl.in/2rzc [12]
21 From BBC news, http://news.bbc.co.uk/ [13]
1/hi/business/8059861.stm
22 see Independent, http://xrl.in/2rzd [14]
23 See http://en.wikipedia.org/ [15]
wiki/United_States_public_debt)
24 See report a Bloomberg, www.bloomberg.com/apps/news?pid=newsarchive&sid [16]
25 Marx Capital volume three, chap 29, http://www.marxists.org/archive/marx/works/1894-c3/ch29.htm [17]
26 Sismondi, Nouveaux principes [Seconde édition, Paris, 1827], II, p. 230.)
27 See http://news.bbc.co.uk/1/hi/business/8169596.stm [18]

Links:
[1] http://www.fifthinternational.org
[2] http://www.marxists.org/archive/marx/works/
[3] http://www.marxists.org/archive/
[4] http://www.fifthinternational.org/index.php?id=85,1329,0,0,1,0
[5] http://www.reuters.com/article/ousiv/idUSTRE52966Z20090310
[6] http://www.marxists.org/archive/marx/works/1894-c3/ch30.htm
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