Capitalist Production Good, Capitalist Finance Bad

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Tony Norfield, 6 January 2014

Costas Lapavitsas, *Profiting Without Producing: How Finance Exploits Us All,* London: Verso, 2013, 352 pages

This book aims to provide a Marxist interpretation of the global crisis, putting it in the context of a new phase of capitalism, one that is characterised by 'financialisation'. There are many definitions and uses of this term, and the book's back cover claims that it is 'one of the most innovative concepts to emerge in the field of political economy in the last three decades, although there is no agreement on what exactly it is'. In Lapavitsas's view, however, 'The transformation of the conduct of non-financial enterprises, banks and households constitutes the basis of financialisation' (p. 4). In this review, I will assess the arguments made in favour of such a definition and Lapavitsas's view of modern finance, both of which are problematic.

Key theoretical issues

After opening with a brief chapter on the rise of finance, noting especially the explosion of derivatives trading, Chapter 2 of the book ('Analysing financialisation') discusses the literature of recent decades, both Marxist and mainstream. This is very useful for providing a review of diverse approaches to the topic while also indicating Lapavitsas's own perspective. His discussion of the *Monthly Review* School, which was among the first in more recent times to focus on the rise of finance, is interesting because it opens up his own theoretical position. He notes that *Monthly Review* basically has an under-consumptionist view of capitalist crises, similar to a Keynesian one, and that it sees the move into finance as a result of non-financial companies escaping from a stagnant productive sector (p. 17). His critique of this view is that it cannot explain the changed behaviour of non-financial corporations, banks and households from the 1970s and he suggests that this change of behaviour rests upon economic reasons (pp. 17-18). But then he only promises an *examination* of the three changed behaviours, not of the economic reasons behind these changes: 'the examination of non-financial enterprises, banks and households takes up much of the rest of this book' (p. 18). As will be discussed further below, this sidesteps identifying a causal explanation for the broad financial developments from the 1970s. It is also worth noting that it is odd to exclude a wide range of financial institutions outside the banks - pension funds, insurance companies, hedge funds, stock exchanges, etc - from his general definition of 'financialisation'. Another indication of his theoretical stance comes when he criticises Arrighi, making the point that the world market is 'a creation of industrial, commercial and financial capitals that have become dominant in their respective national economies'. The latter statement is not the self-evident proposition it might seem, however, and would not account for

those companies whose operations are based on the world market, rather than emerging from the national economy, as is the case for BP, for example. However, the bigger problem is when he turns this into an argument for saying that the 'logic of theoretical analysis ought to run from the national economy to the world market' (p. 19). Apart from being a *non sequitur*, it is an argument that also contradicts, without comment, the analyses of Marx and Lenin, and of the Marxist tradition more generally. Of course, Lapavitsas recognises that the world market has an impact upon national economies, and he also states that 'financialisation is inherently bound up with the US dollar operating as the dominant form of world money since the 1970s' (p. 19). But the issue is more fundamental: the world market is the platform on which global capitalism operates, and one cannot understand 'world money', for example, unless one starts from a *world market* perspective, not a national one.

In Chapter 2, Lapavitsas also rejects the idea that the development of financialisation has anything to do with Marx's law of the tendency of the rate of profit to fall, or that falling profitability in capitalist *production* was a key factor behind the rise of *finance*. Instead, he stresses that 'the processes of finance should be analysed in their own right' (p. 37). However, this is a strange counterposition of arguments. Analysing finance would be necessary *whatever* the underlying dynamic of developments might be, but analysing financial ‘processes’ does not necessarily reveal that dynamic. Having rejected the profitability cause, he has not furnished another one in its place and is basically left with a descriptive approach to the phenomenon: analysing the processes of finance. This lack of need for one or more causal factors might be justified in his view because 'historical and institutional variation is a necessary feature of financialisation' (p. 39). However, even the most concrete developments, especially ones that dominate society, are liable to have been driven by a more general and systemic social dynamic.

I have a more positive assessment of the book's Chapter 3, which deals with the rise of finance at the end of the 19th century and the response of key Marxists to these developments, especially Hilferding and Lenin. Lapavitsas discusses Hilferding's theoretical innovations in the examination of new forms of finance, while bringing out the limitations of his Austro-Germany centred analysis. This chapter is also used to note that some issues are different for today's global capitalism: for example, whereas Lenin argued that the rich imperialist powers lived off rentier incomes from their loans to other countries, today rich countries, particularly the US, are more commonly *borrowing from* poor countries (p. 67). That is a reasonable observation to make, but also one-sided. Lapavitsas does not discuss the broader issue of how such borrowing helps finance higher-yielding foreign investment from the US (and the UK), nor the fact that the US and other rich countries *do* still earn rentier incomes. In 2012, US gross investment income from abroad was $770bn, while the net figure after income payments was $232bn. Not bad for a country that has a huge net *debt* position! Neither does he pay much attention to the commercial power of the major countries in the world market. Chapter 4 on the 'monetary basis of financialised capitalism' is also a useful review, covering Marx's theory of money, fiat money, private credit money, state-backed central bank money and the US dollar's role as 'quasi-world money'.

Chapter 5 on 'finance and the capitalist economy' is a further discussion of theoretical

issues, including mainstream theories of finance. He makes a key point that a financial system is 'a specifically capitalist phenomenon, although sophisticated financial practices can be observed in a wide variety of other social formations' (p. 109). For me, the points of interest in this chapter are Lapavitsas's discussion of Marx's concepts of interest-bearing capital (IBC) and loanable money capital (LMC), and the issue of whether capital invested in banking/finance would tend to have the same rate of profit as for industrial and commercial capitalists. There is a good discussion of IBC on pages 112-118, which clarifies that Marx's concept relates to a (money) capitalist advancing funds as capital to a productive capitalist for investment purposes. Here, the money capitalist gets a return in the form of interest, where the interest is a deduction from the surplus value produced from the investment. This is not to say that surplus value is necessarily always produced. LMC is a more general concept that includes IBC plus the spare funds arising from the industrial-commercial circuit of capital and the idle funds of all social classes (usually deposited in banks). As Lapavitsas puts it, 'the money market is the site where loanable [money] capital is traded' (p. 131). Such trading will result in a rate of interest for the loaned funds, but this can give the impression that basically the same thing is going on with every deal, which is incorrect. Some transactions are advances of IBC, but others will come under the heading of money-dealing capital, where money is loaned to industrial and commercial companies as a means of payment. For Marx, IBC receives a distinct category of interest, one that is determined quite differently from the average rate of profit. By contrast, while the second transaction involves an interest payment, it is one that will tend to generate an average rate of profit for the money-dealing capitalist. These operations in banks are often combined in one business, but the conceptual distinctions are still important for Marxist theory.

Lapavitsas appreciates these points, but then proceeds to confuse matters. In a response to an article of Ben Fine's from the mid-1980s (p. 127, footnote 45), Lapavitsas seems to be arguing that the rate of profit for banks should be the *same* as for other capitalist companies. This was also Hilferding's view, but it is not present in Marx's analysis because of the distinct position of IBC compared to industrial and commercial capital. Fine argued that profitability for banks is different (using 'banks' as a generic term for capital engaged in finance), because banks are not liable to provide funds for new entrants into banking as they would into other sectors (banks being agents of competition elsewhere, not between themselves). Competition in banking/finance for Fine does not establish a normal, equalised rate of profit, but gives rise to interest as a claim on surplus value prior to the distribution of profit of enterprise. Lapavitsas misrepresents Fine's view on this question.[1] I agree with Fine that profitability for banks is conceptually different, but would also stress that the licensing system for setting up a new bank helps maintain a monopoly over access to deposits. This also leads to a different form in which both profitability and interest appear for banks compared to other capitalist companies.

This might seem to be a side matter, but it reflects a tendency in Lapavitsas's argument to gather a wide range of phenomena under the heading of 'financialisation' and in the process to obscure some important Marxist concepts that would otherwise throw more theoretical light on what is really happening in the world. This is true in Chapter 6 on

'financial profit', for example, a chapter that discusses topics rarely covered in any detail in other Marxist literature.

Financial profit

In Chapter 6, Lapavitsas begins his discussion by revisiting a term that he has used in other publications: 'profit from alienation or expropriation'. This is not the standard form of exploiting workers in capitalist production, but 'exploitation in financial transactions', which, in the case of workers, amounts to a 'direct transfer of value from the income of workers to the lenders' (p. 143). This is the basis for his notion that finance 'exploits' the working class, and not only the other capitalists, so that it 'exploits us all', as in the subtitle of the book. He has been criticised a number of times for this concept of 'financial exploitation' because the term exploitation has a particular meaning for Marxism, based on the appropriation of surplus value from workers in capitalist production, but he continues to use it here.[2]

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.

While there may be instances of predatory lending that eat into workers' disposable incomes, *if* the interest payments, fees, etc, take the widespread, persistent and systematic form that Lapavitsas assumes under 'financialisation', then ultimately the deduction is from surplus value, *not* from the value of labour power. Lapavitsas attempts to justify this theoretical inconsistency with some citations from Marx's writings that have no direct relationship to the point of criticism, being based on a misreading of Marx or by a false analogy with rent (pp. 144-146).

The point Lapavitsas essentially makes is that 'financial profit ... could also emerge from expropriating the income and money stocks of others through the operations of the financial system', and not just from a division of surplus value produced (p. 145). However, in particular for the working class, this confuses the form of payment with the value relations underlying the payments. He makes things worse by arguing that contemporary financial expropriation 'represents a throw-back to ancient forms of capitalist [*sic*] profit-making that are independent of the generation of surplus value' (p. 146), a statement that leads into five pages of tangential discussion of Aristotle's views on predatory finance! This completely misconstrues modern developments. Rather than today's financiers rediscovering old methods for gouging profit from the vulnerable

populace, their operations have evolved alongside the demands of contemporary capital accumulation, from the euromarkets to financial derivatives, as will be discussed further below.[3]

After Aristotle, Lapavitsas discusses the important question of leverage. Here, a capitalist company might borrow funds from a bank, something that will alter its 'rate of profit of enterprise' compared to the average rate of profit, depending on the level of the interest rate (pp. 151-155). This is an issue often overlooked when considering capitalism and finance. The surprising thing, however, is that Lapavitsas does not discuss the fact that *bank* leverage ratios are a large multiple of those for industrial and commercial companies, based on the banks' position in the credit system.[4] That would have been a far more pertinent angle for the discussion of financial profit. The banks do not merely gather up society's idle funds and lend *these* out - they also create *new* deposits and loan assets, and can do so up to (and beyond) prudential limits. This fact stands in stark contrast to Lapavitsas's view, expressed later, that the 'owners of loanable capital as well as the institutions that handle its flows have a limited capacity to augment its magnitude through their own actions (p. 203).[5] Bank assets are commonly more than 20 times a bank's equity capital and the ratio can be expanded as required. Rising leverage ratios were a major boost to bank profits during the credit bubble, and bank profits collapsed as assets were written off (loan defaults, etc) when the bubble burst.

Lapavitsas also discusses 'trading financial assets' (p. 163), and how financial profits can be derived from fictitious capital values. The aspect he focuses upon is capital gains, as in Hilferding's conception of founder's profit. Here, shares in a company are floated on the stock market for a total sum that exceeds what is needed for investing in the company (assuming the rate of discount/interest is less than the company's rate of profit). The excess value is realised by the founders/owners when they sell shares to others, or can be accounted for as more wealth in the form of the higher fictitious capital value of their own shares. He follows up this basic example of founder's profit and argues that the process is essentially the same for all kinds of capital gains on financial assets, when the seller makes a profit in a rising market and the 'final buyer' obtains rights to the 'entire flow of surplus value from the project but at a greater expense than each previous owner of shares' (pp. 164-165).

When it comes to financial securities that are the liabilities of *workers* not capitalists, however, as in mortgage bonds or consumer debt, Lapavitsas returns to the notion that the source of this financial profit is (future) wages (p. 167). He also argues that the creation of mortgage bonds from mortgage payments means that the 'money revenue of workers is transformed into loanable capital' (p. 167). However, it is loanable money capital that is advanced *to* the workers, and the securitisation of the mortgage payments as a bond *does not create* loanable money capital. Secondly, while mortgage payments deducted from workers' incomes do go to financial companies, in general these are not deductions from the value of labour power, as explained above.

A final point on financial profit is worth making here. Lapavitsas has built his exposition around *capital gains* on financial securities. While he mentions the fees and commissions that are part of the trading in such securities, he does not deal with the financial 'profits' that result from such trading. These profits result largely from bid-offer spreads for

dealing in securities, currencies, etc, and from the privileged market-making position of bank dealers versus other dealing counter-parties. Such profits have no relationship to changes in the price of the security traded, as they do in the example of capital gains. Profits from financial trading are very important for the banking sector, especially in a major centre of global financial trading such as London.

Financial developments and data

Chapter 7 on 'financialised accumulation' introduces section 3 of the book, one that deals more closely with the empirical and historical features of financialisation. The underlying theme remains the altered conduct of non-financial corporations, banks and households, but Lapavitsas argues that it should not be a surprise if 'the form of financialisation varies greatly between countries' (p. 171). This statement is consistent with his theoretical approach of going from the national economy to the world market (see above). However, it means that he cannot explain the relationship between the world market and the forms taken by financialisation, since it is a country's position in the world market that will determine the financial options available to it. Chapter 7 is mainly a repetition of the common view in radical literature that financialisation was responsible for lower economic growth (at least, lower real wage growth) and rising inequality. In this chapter, Lapavitsas also notes a variety of other issues - from attacks on trade unions, to central bank policy, to the role of the US dollar, to measures of productivity - but it is not clear what relationship these developments have to his main arguments.

Chapter 8 examines the 'tendencies and forms of financialisation' over sixty pages. Here Lapavitsas discusses developments in four major capitalist powers, the US, Japan, Germany and the UK, comparing and contrasting trends in the financial sector data and their relationship to the domestic economy. The value of this chapter to the reader depends on what the reader already knows, but that is not to say it is necessarily valuable for those with little knowledge of financial trends. One should be cautious about accepting a mass of empirical evidence as giving a good outline of the full picture: it may simply stress particular dimensions and exclude other important ones. Four examples are relevant here.

Firstly, Lapavitsas argues that financial profits have risen a great deal in recent decades as a share of total profits, but his charts are not very supportive. Figure 8 for the UK (p. 215) notes the profits of financial corporations as a share of total profits. But the line dips sharply from 1989 to 2000 before rising to a new peak by 2007-08. Figure 9 for Japan (p. 217) shows a slightly declining share between 1994 and 2007. Only the US chart looks like a longer-term upward trend.

Secondly, who receives the financial profit from financialisation? Lapavitsas notes that new social layers have been created, 'receiving finance-related income and bearing only a passing resemblance to the rentiers of old' (p. 217). However, he does not discuss who these people are. If they are not, or not only, a social stratum of the rich, moneyed capitalists living off interest, as depicted in classical Marxism, then who are they? Later, he notes that household assets have been 'a source of financial profit both in terms of fees earned by the institutions involved but also in terms of capital gains and

transactions in financial assets for both intermediaries and final holders' (p. 243). This formulation avoids stating clearly the fact that a large number of households in rich countries - owners of financial securities and pensions - are *also* recipients of financial profit, either in the form of capital gains or as interest-related income. But then finance is supposed to 'exploit us all'.

Thirdly, despite the extensive data coverage for the four countries, Lapavitsas gives no data for the financial benefits each receives from other countries, neither in terms of foreign investment income nor on the financial services revenues that accrue to them. These are key issues for British imperialism, and also for the US, but they do not come into his coverage of 'financialisation'. At most, the benefits are noted summarily for the US, mentioning subsidies from dominated powers via the build up of foreign exchange reserves (p. 252). Furthermore, since 'finance exploits us all', there is no coverage of the huge property *assets* of many households in the rich countries. In the UK at least, these more than offset the total of mortgage debt *liabilities* to the banking system.[6] This is not to deny that many people have large mortgage debts that might exceed the value of their residential property, but the omission of these important assets is consistent with the absence of any consideration in Lapavitsas's work that a mass of people in the rich countries - not just financiers or capitalists - have economic privileges.

Fourthly, the view that 'financialisation' has gripped all the major countries may seem plausible, but it is not backed up by all the charts that Lapavitsas includes for the four countries covered. For example, commercial bank assets (pp. 234-235) in the form of household mortgages and loans to individuals did rise as a share of total assets in the US, but were still only around 25% of assets by the mid-late 2000s. In Japan, the share rose too, but only to around 10% of bank assets, while in Germany the share was flat at around 10%. In the UK the share of such loans *fell* from around 23% to around 15% in the decade to 2009. Not exactly a substantial or pervasive change.

A general problem with this approach to financial developments is that it leads to a very restricted view of what is going on in the imperialist world economy. This is also true when he discusses 'subordinate financialisation' among countries dominated by imperialism. His focus is on the incursion of foreign banks that, he argues, changed their domestic financial systems and mimicked selected trends in the rich countries, such as bank lending to households (p. 246). This perspective follows from his overall view of financialisation, but it hardly does justice to the real tribulations faced by subordinate countries. To give some appreciation of these, he does note a quite different point, that poor countries lent funds to rich countries (especially the US) at low interest rates via foreign exchange reserve accumulation (p. 252). But, while important, this fact does not fit into the theoretical framework that he has constructed about what is new in 'financialisation'.

Chapter 9, 'tending to crisis', begins with an interesting review of Marx's theory of finance and crises before moving on to how the financial form taken by capitalist crises is different in conditions of modern capitalism than in Marx's day. The objective of this chapter appears to be one where he wants to explain 'finance as a factor of capitalist crises' (p. 260), but as a factor that can operate separately from one or more fundamental causes. The subsequent discussion of the financial bubble and bust from

2001-2009 repeats the standard view that it was a sub-prime crisis emerging from the US. He does not discuss why the US Federal Reserve had kept interest rates so low in the early 2000s, except to see it as a policy response to the bursting of the dot.com bubble of 1999-2000 (p. 271). Nor does he discuss why the toxic mortgage securities emerging from the bubble were so easily distributed around the world, and whether this too might have had some relationship to problems of capital accumulation and low returns on investment. The key point emerging from the first half of this chapter is that Lapavitsas sees the crisis as resulting from a malfunctioning of the financial system (a 'Type 2' crisis, p. 271), rather than having any relationship to capitalist profitability.[7]
In the second half of the chapter, Lapavitsas focuses on the euro area financial crisis. This draws upon his other (co-authored) published work and makes some good points about the systemic problems faced by the euro countries.[8] Much of the ground covered is very familiar, but there is a nice turn of phrase summing up the euro sovereign debt crisis: the weaker countries had found that they 'had borrowed in a currency - the euro - which appeared to be domestic but was in effect foreign' (p. 298). My question, however, is why these developments should be considered a 'crisis of financialisation' in Lapavitsas's terms. Essentially what had happened was simply that the weaker euro countries had borrowed excessively at the low interest rates on offer, and had also lost competitiveness. When the credit bubble burst after 2008, they were left high and dry. Overall, his view is to look upon the euro project as having benefited German capital by providing it with a stable, internal market (pp. 290-291, p. 293). A better assessment would have put the euro project in the context of a longer-term attempt by the major European capitalist powers to meet *'le défi américain'*.[9] The irony of more recent developments is that most of Germany's trade surplus now originates from *outside* the euro-17 countries (64% in 2012).

Controlling finance

The final Chapter 10 on 'controlling finance' draws together the previous themes, but it reaches a conclusion that is at first sight surprising for a book within a Marxist perspective. Yet, if one follows through the logic of the previous arguments, especially the view that the current crisis results from a malfunctioning of the financial system, then this is not so much of a surprise. Lapavitsas considers at length a number of mainstream and radical proposals on regulation to deal with the malfunctioning and then comes up with his own solution. He calls for the creation of a public sector bank! Not a demand for more regulation, since his analysis has shown that the financial system - and pervasive financialisation - will find ways around any new rules (pp. 323-324). Nor a simple demand for bank nationalisation, of course, because most of the equity of some big banks in the UK and elsewhere has *already* been taken into state ownership. Instead, he advocates ‘publicly managing the flow of credit to households and non-financial enterprises to achieve socially set objectives as well as to eliminate financial expropriation’ (pp. 324-325). He adds that these public banks ‘would be able to adopt a longer-term horizon in lending, helping to strengthen the productive sector and to reverse financialisation’ (p. 325).
I was tempted to compare these views with those of the Archbishop of Canterbury, who

last year called for splitting up big banks and making them good for society. But it is more telling to give some further details of the Lapavitsas plan.
He admonishes the banks for their failure to monitor credit quality, so he decides to take the issue seriously in the case of his proposed public institution. After all, strengthening the capitalist productive sector cannot be achieved by giving cheap loans to dodgy prospects; that would waste social resources. So, there would be 'publicly determined rates of interest', varying among different borrowers, and public banks would 'deploy the techniques of information collection for income, employment, and personal conditions, including credit scoring and quantitative risk management' (p. 325). Thus, we can see how scientific calculation will overcome the evils of financialisation and capitalist markets!
As an exercise in utopianism, this is hard to beat. Let's leave aside the fact that there is a global monopoly network of huge corporations that has control of distribution channels and supply chains, technology patents and product licences, quite apart from the backing they get for international trade and investment deals negotiated by their states. But this policy proposal shares the common superstition among radicals, one alien to Marxism, that the capitalist state is a neutral bag of tools that can be utilised in favour of the masses. Lapavitsas had already noted that large corporations do not really depend on banks for loans, so presumably he envisages offering loans to small- and medium-sized enterprises, ones that have not already been crushed by monopoly power and which often already depend on state support for their products and services. But one does not take a peashooter to a gunfight.
Lapavitsas also sets aside the fact that banks already monitor credit risks and so are reluctant to lend to such companies by arguing that they are not very good at it, confident that his proposed public bank would do a better job. He does not consider the fate of failed versions of his more 'social' banking, for example, the Spanish Cajas and the UK's own Co-operative Bank. In the next sections, I will discuss further some theoretical and empirical issues in the analysis that Lapavitsas has offered.

What is, and what led to, financialisation?

Earlier I noted that Lapavitsas's approach to the question of financialisation was essentially descriptive, leaving unclear the reasons behind the changes in financial markets since the 1970s. The explanation has many dimensions, but these are not to be found in the book. His description, based around the changed behaviour of the three elements of the economy he identifies, consists of the following elements:

- Non-financial companies shifted from borrowing directly from banks and undertook their own borrowing from capital markets, in the process gaining financial expertise;
- Banks responded to this by shifting business to more financial trading and to lending to households in various ways (mortgages, credit cards);
- Households found that, after neo-liberal economic reforms, they were more engaged in providing for themselves pensions, health care and housing, all of which increased their involvement with financial markets.

I would query a number of these points. Firstly, large corporations have always, and especially in the US and the UK, depended for the bulk of their investment financing on

internal funds, ie retained profits. Their relationships with banks have been most active in money-dealing services, including foreign exchange and short-term credit provision. Secondly, while it has been true that non-financial corporations have in recent decades raised more capital from bond and equity markets at the expense of long-term borrowing from banks, the banks have, in turn, made a growing business from floating these bonds and equities for a fee. The corporations do not sell their securities themselves. This has been one of the reasons behind many 'commercial banks' turning themselves into 'investment banks', or at least opening up an investment-banking arm. Thirdly, the data do suggest that there has been a growth of household mortgage debt and also more personal investment in private pensions, so increasing the involvement of households in financial markets. However, as argued earlier, this does not support Lapavitsas's claim that household incomes have been an ultimate source of financial profit.

Lapavitsas notes the important role of the state, saying that: 'As far as financialisation is concerned ... the transformation of mature economies would have been inconceivable without the facilitating and enabling role of the state'. He then argues that there are three features of the state's role: the command over state-backed central bank money (especially since the break with gold from 1971); enabling the global spread of financialisation through command over world money (via the role of the US dollar); and by smoothing the path of financialisation by altering the regulatory framework for finance (pp. 192-193). These are the factors often included in accounts of capitalism since the 1970s, but he offers no causal dynamic to explain these changes. For example, he does not explain many governments' implicit and explicit support for financial deregulation from the 1970s when there had in previous decades been far more controls in place. Did governments spontaneously embark on this new policy? Or were there more fundamental trends to which they responded and which led to financial deregulation, etc?

More importantly, missing from Lapavitsas's account is an assessment of what drove the boom in financial transactions and other forms of 'financialisation'. I think there are two key factors here: an underlying problem of weak profitability and the particular financial form that this took.

In my view, the greater role of financial transactions and international flows of capital in the world economy over recent decades was not such a sharp break from the previous 1945-1970s period as many proponents of the 'financialisation' concept maintain, although these developments were, of course, accelerated after the breakdown of the Bretton Woods monetary system. But that breakdown was a result both of the changing balance of power in the world economy, as US hegemony weakened, and of the increasing difficulties faced by capital accumulation as profitability fell on a world scale. Even prior to the Bretton Woods collapse, there had been a dramatic growth of the euromarkets and other international financial flows from the late 1950s, based on the demands of major world corporations for finance.[10] These led many governments, particularly those under pressure, to complain about the increased 'hot money' flows, as with UK Labour politicians' attacks in the 1960s on the 'gnomes of Zurich' (a phrase that conveniently excluded the parasites of London). The law of value operating

internationally - what are you producing and what is it worth in the world market? - which also led to the evolution of new forms of finance, was behind the collapse of Bretton Woods.
The stagnation-inflation turmoil of the early 1970s brought about further financial developments, including the removal of most of the international capital controls in the US, Canada and Germany, together with industrial restructuring, higher unemployment and austerity measures as governments and companies tried to deal with the crisis. This is the backdrop to what is termed the 'neoliberal' period from the late 1970s, epitomised by Reagan and Thatcher. The policy actions of the latter governments, including a sharp rise of interest rates after 1979 to control inflation, are more accurately described as *further* attempts to try and restore conditions for profitable accumulation rather than as shocking new developments. Still less can they be described as measures to support the 'ascendancy of finance' (p. 194), unless it is also admitted that the parasitic form of capitalism in the key powers also meant that the 'financial' option seemed a lucrative one when they had such difficulty in making domestic production profitable. The US and British states, in particular, boosted the financial sector as a deliberate policy to improve their ability to appropriate value from other countries, especially after 1979 but also before. Market pressures forced other countries to adapt to these moves from the major, financially oriented powers. This is the real substance of the phenomenon labelled 'financialisation'. In contrast to Lapavitsas, I would argue that problems of profitability and capital accumulation, particularly as these issues affected the US and UK, do lie at the root of what he calls financialisation.

Capitalist profitability and financialisation

Almost all measures of the rate of profit for major countries show a trend *decline* from the 1950s into the early 1970s. As a result, there is little dispute about falling profitability as the underlying cause of the 1970s economic and financial turmoil, at least among those who claim to base their views on Marxist theory.[11] For the period from the 1980s into the mid-2000s, the consensus in the literature is that the rate of profit was on a *rising* trend, at least as measured for the US. There is far from universal agreement that this is correct,[12] but the common view is that the crisis starting in 2007 in the rich countries was a result of financial excess, rather than having any relationship to a capitalist profitability crisis. The financial form of the latest crisis - a massive build up of debts, speculation, fraudulent deals, etc - has encouraged this perspective.
In line with this latter view, Lapavitsas characterises the latest crisis as emanating from a 'malfunctioning of the financial system', what he calls a 'Type 2' crisis, rather than one that originates in the industrial and commercial circuit of capital (p. 266, p. 271) or one that can be said to be an accumulation crisis based in any way upon profitability. In particular, he dismisses the opinion that treats 'financialisation as the flight of capital from a stagnating productive sector' (p. 18).
My views on the current crisis, the question of capitalist profitability and the growth of finance are different. On the question of data, I think it is not possible to get a good approximation for the rate of profit in the capitalist system as understood by Marx. Apart from anything else, there are problems of allowing for productive and unproductive

labour, the impact of a monopolistic world market on value calculations, data inaccuracies, tax havens and the methodology of compiling the data.[13] Despite this, it is a natural urge for many, especially those analysts interested in Marxism, to use the available data to examine profitability trends. I sympathise with this effort, but remain sceptical about whether it is possible to make a good job of it. That said, I would agree that it would be odd if there were a major crisis, as we have today, and the available data showed that the rate of profit in the years ahead of the crisis had been relatively high. Some measures of US profitability do indeed show relatively high rates of profit ahead of the crisis and that would appear to give support to the 'financial malfunction' thesis of Lapavitsas and others. However, one does not need to accept the available data on profits uncritically, especially for the US.

I would note three factors that put any calculation of rising US profitability from the 1980s in a different light, whether one measures it for the overall corporate sector, or whether one tries to make a separate measure for industrial and commercial companies.[14] The first was the attack on working class living standards by the US government and business, the use of migrant labour and the marginalisation of labour unions. To some extent, this effect can be measured, although there are debates on what productivity, price, wage and benefits data to use, and this factor was probably significant. However, it was likely to have been more of a one-off factor, and most measures of US rates of profit show lower rates into the end of the 1990s.

The second factor has arguably been more important, but it does not directly appear in *any* US data: the impact of low cost products available to US capital through trading relationships with low wage countries, particularly China. These reduced the cost of living for most workers and also provided cheap inputs for business. Lapavitsas notes the so-called 'Great Moderation' (p. 194), the term used to describe the apparent success of US policymakers in achieving reasonable growth together with lower inflation. But he does not mention this crucial point that helped underpin that success, one that relied upon the introduction of many tens of millions of new, super-exploited workers into the world economic system from the 1980s. Some Marxists dispute this factor, implicitly assuming a similar rate of exploitation for all workers - otherwise, it might seem to be strange why capitalists invest in the richer countries at all, and why they do not fully migrate to the low wage areas. However, one should also consider the stratification of global production between rich and poor countries,[15] and the political factors behind immigration controls in rich countries, including working class support for these, something that has prevented an equalisation of rates of exploitation. Overall, this factor was a significant boost to global profitability, but its incremental impact will now be much less.

The third factor boosting US corporate profitability for industrial and commercial capitalists was progressively lower nominal and real interest rates.[16] This development was based on an unwinding of the previous very high rates that followed the tightening of Fed policy in the early 1980s, on the success of capital in attacking the US working class, on the low cost of imports and on Asian countries accumulating huge foreign exchange reserves (buying US securities and so *reducing their yields*) as an insurance against financial trouble after the crisis of 1997-98. The end result was a sharp rise in US consumer borrowing, a relative decline of interest income for the banks, a rise in the

price of financial securities, more financial trading and credit-fuelled demand for the products of industry and commerce in the 2000s.[17] The problem now is that nominal US interest rates cannot really be pushed any lower.
This was the real world backdrop for the 'financialisation' phenomena. As these summary points indicate, financial developments are multi-faceted and their relationship to the rate of profit is complex. However, at the very least, one should not look upon any data showing credit-fuelled profit rates for the period up to 2007 as being a sign of healthy capitalism![18] It should also be noted that the recorded profitability of US companies (such as Wal-Mart and Apple) might not necessarily have much relationship to the profit arising from their *domestic* US operations. That would help explain the apparent paradox that US corporate profits might be high while (domestic US) investment remains weak.

Conclusion

Lapvitsas's book has raised many issues and gives valuable food for thought in coming to an understanding of the global crisis. The financial form of the crisis is a challenging phenomenon to unravel, but Lapavitsas's approach is wrong on several counts. He rejects what he would judge as a simplistic, or simply invalid, 'falling rate of profit' explanation of the crisis and financial developments, but then only proceeds to describe the (autonomous) development of financial processes. Even here, as I have argued, there are serious gaps in his coverage. He also sets up the concept of 'financial exploitation', particularly of workers' incomes. This is not only at odds with a standard Marxist understanding, despite his exaggerated claims to the contrary drawing upon usury. It is also used to make a distinction between the financial capitalists who exploit *without* producing and those capitalists who exploit *in the process of production*. The reader cannot come away without getting the impression that the latter is fine, or at least the lesser of two evils, especially when his conclusion is that 'public banks could support the provision of banking services to real accumulation as well as to households' (p. 324).

Finance is not a simple, parasitical outgrowth of the 'productive' capitalist economy, as Lapavitsas has argued well when looking at the operations of big corporations and their relationship with the financial system. However, this insight does not prevent him from counterposing the two. His 'national to world economy' perspective has also led him to overlook important features of finance that would have elucidated the role of finance for the major imperialist powers, in particular the US and UK. Identifying different forms of capital, especially the financial ones, is important for understanding the workings of capitalism. But, despite the Marxist guise, this book ends up as yet another form of anti-finance populism that, despite being critical of capitalism, seeks to restore the health of the capitalist economy.

Tony Norfield, 6 January 2014

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[1] Fine does *not* argue in that article that banks do not lend to *each other* as Lapavitsas claims, a point that would obviously be an absurd one to make. In addition, Lapavitsas

seems to misunderstand, and misrepresents, Fine's argument from the earlier paper that banks/finance can combine different forms of capital in exchange together, something which Fine takes as key in understanding the notion of financialisation (in contrast to Lapavitsas's view of financial exploitation) as in a much more recent paper unacknowledged by Lapavitsas (see footnote 2).

[2] Ben Fine has offered the most telling critique, one argument of which is summarised in the next paragraph (see 'Locating Financialisation', *Historical Materialism*, 18, 2010). Lapavitsas does not refer to this article in his book. In two presentations of the book, made at SOAS in London in October and November 2013, Lapavitsas did not answer questions on this particular topic from the audience, including from myself.

[3] See, for example, the author's discussion of developments in financial derivatives as one response to problems of capital accumulation in 'Derivatives and capitalist markets: the speculative heart of capital', *Historical Materialism*, 20 1, 2012.

[4] For a brief discussion of this issue, see 'Bank profits and leverage' on this blog, 25 August 2011. A fuller treatment is in 'Value theory and finance', *Research in Political Economy*, 28, 2013.

[5] Lapavitsas does, on occasion, briefly refer to bank credit creation, but, as these points indicate, it has no role to play in his broader analysis. It is one of the paradoxes, rather failures, of Marxist discussion of the banking system and finance that the basic mechanism of bank credit creation, included in all mainstream economics macro textbooks, rarely gets a mention.

[6] Property assets are usually not included as part of financial assets in official statistics, but to exclude them leads to a distorted picture. UK data for 2008-10 estimate a total *net* property wealth (*after* deducting mortgage liabilities) of £3,375bn! [Correction, 19 January 2014: footnote 6 of the article when first posted incorrectly added that median household *net property wealth* was £340,000, however this figure was the median for the top 10% of households]

[7] His 'Type 1' crises, by contrast, are where monetary and financial crises are 'an integral part of industrial and commercial crises' (p. 165).

[8] However, the points raised about diverging competitiveness within the euro area and potential problems for central bank policy were included in many reports from banks in the City of London and elsewhere in the early 2000s.

[9] This is the title of a famous 1967 book by Jean-Jacques Servan-Schreiber, a French politician. Germany has obviously played a key role in the development of the euro project, but this project was based upon the coincidence of interests of several major European powers. Germany was actually one of the most reluctant to internationalise the euro. It is often ignored in radical denunciations of Germany's role, as also in this book, that Germany has *subsidised* other euro countries. For more on these topics see other article on this blog: 'The Imperial Balances' 12 September 2012, and, for a more general discussion of the euro project and its relationship to imperial rivalry, 'Cameron, Merkozy and Europe', 12 December 2011.

[10] Lapavitsas makes some similar points at the end of his book to the ones formerly mentioned in this paragraph (p. 311), but the thrust of his argument is to stress the novelty of the financialisation phase.

[11] This is not to say that there is no dispute about the reasons for the fall in profitability into the 1970s! There are basically two camps here: those who argue that profits fell because of higher wage settlements (usually welcomed as an attack on capitalism - how times change!) and those who argued it was based upon a rising organic composition of capital. I am in the latter camp, but note that the difficulty of getting more surplus value out of the domestic workforce was an important driver of the later trend towards 'globalisation' and the shift of production to low wage, more exploited workforces elsewhere.
[12] See, for example, the work of Guglielmo Carchedi, Alan Freeman, Andrew Kliman and Michael Roberts, among others. For a recent review of some profitability issues, see Michael Roberts' blog: http://thenextrecession.wordpress.com/2013/12/19/the-us-rate-of-profit-extending-the-debate/
[13] This article is a book review, so neither will I discuss the additional headaches of considering questions such as historical cost versus current cost of investments, and of the relatively new official device of attributing the financial sector its own 'value added', labelled FISIM in the UK.
[14] In US statistics, comparable data exist for calculating an overall corporate sector profit rate (using a measure of profits versus fixed assets, as is commonly done). However, it is far trickier to get the necessary data for the non-financial and financial sectors separately.
[15] John Smith discusses this important point about North-North and South-South competition. See, for example, 'Southern labour—“Peripheral” no longer: A reply to Jane Hardy', *International Socialism*, 140, 7 October 2013.
[16] Financial capitalists managed to boost their profitability as interest rates fell in this period by raising their leverage, as noted earlier, especially in the US.
[17] See my article, 'Derivatives and capitalist markets', *Historical Materialism*, 20 1, 2012, for an examination of some of these trends.
[18] The more recent recovery in bank profitability is largely due to wider interest rate margins, backed by low central bank interest rates in many countries and an implicit or explicit state guarantee on their credit.