Contemporary Financialization: A Marxian Analysis
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Introduction

Over the past forty years, there has been a resurgence of global financial capital. Finance, always having played an important role in the circulation of capital and reproduction of capitalism, has taken on distinctive and more expansive roles. Financial profit, and new ways of harnessing it through an array of more and more exotic financial assets, has become central to both financial and non-financial corporations. Intricately connected with this has been the financialization of the household through household and consumer debt and the related growth in asset bubbles. This system, as vividly demonstrated in the 2008 global financial crisis, has become increasingly unstable.

This paper unpacks various facets of contemporary financialization using Marxian political economy to ground the phenomenon in a theoretical framework and real historical movements.[1] Marxian political economy has much to offer the study of contemporary finance and the process of contemporary financialization. This process is fundamentally a shift in the balance between the spheres of production and circulation, in favor of the latter, as domains for the investment of capital and garnering of profit.[2] This is, of course, not unproblematic as profits in the former are supported by the extraction of surplus-value, whilst rooted in claims to paper wealth in the latter. This distinction, however, should not be misconstrued as a rupture between these two spheres. Indeed this is a common flaw in mainstream analysis, which depicts the

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[1] In different works Marx lays a foundation for understanding both the historic development of the credit system and some of its key dynamics. Following Marx, Rudolf Hilferding's Finance Capital, published in German in 1910, stands out as the best developed Marxist approach to financial markets and it is upon aspects of this work that Lenin drew in his own writings on imperialism. Subsequently however – with notable exceptions most importantly of Sweezy and Magdoff, and Kozo Uno – Marxian political economy has offered little on issues of money and finance until a recent resurgence of interest in this topic, the writings of which form much of the basis of this paper.
[2] Costas Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," *Ekonomiaz* No. 72, Vol 3 (2009).

financial sphere as floating free from production and detached from the underlying process of accumulation. Marxian analysis, on the other hand, contends that changes in the functioning of capitalism must be understood in light of the functioning of the economy as a whole, rooted in production, and in capitalism's recurrent evolution towards large structural crises that it only supersedes through such transformations. The trends in the rate of profit, in particular its phases of actual decline, are crucial in the occurrence of these crises.[3] The recent phenomenon of financialization is one such transformation and intricately bound up in the health of the "real" economy.

It is not simply the quantitative shift between investment in production towards investment in circulation that is interesting, but also the qualitative shift in various social relations between capitals, and between capital and wage-labor that has been both impetus and outcome of this process. It is these relationships that have become increasingly financialized, with very important consequences.[4] Most remarkably we have observed the ascent and dominance of finance vis-à-vis its relationship to non-financial corporate capital, the state and labor. As Duménil and Lévy have argued this should be understood as the social content of neoliberalism, which is the "ideological expression of the reasserted power of finance."[5]

Finally, the financial system must be understood to stand, historically and logically, upon the back of the credit system. Here Marxian political economy allows credit to be seen on both a micro and a macroeconomic level – as a process taking place between different economic agents and as playing a systemic reproductive role in the circuit of capital. Without this, growth would

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3 Gérard Duménil and Dominique Lévy, "Costs and Benefits of Neoliberalism," in *Financialization and the World Economy* ed. Gerald A. Epstein (Northampton: Edward Elgar, 2005), 17-18.

4 Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," and David McNally, "From Financial Crisis to World-Slump: Accumulation, Financialisation, and the Global Slowdown," in *Historical Materialism* 17 (2009): 56.

5 Gérard and Lévy, "Costs and Benefits of Neoliberalism," 17.

not be possible and, at the same time, would be subject to its own contradictions and instabilities.[6] Underlying this is a particular theorization of money and credit as endogenous to the system.

The above constitute a distinctively Marxian approach. The contemporary process of financialization involves the credit and financial systems functioning in novel ways unforeseen in (and falling outside of) the original schema presented by Marx, Hilferding and others. Nevertheless it must be understood in light of the basic operating and historic evolution of the credit system that has its roots in transformations that took place at the end of the 19th century; these topics make up Section 1 of this paper.[7] Section 2 gives the historic roots of contemporary process of financialization by providing a brief recap of the path of capitalism and the role of finance through the twentieth century, and then pursuing the changes in the global economy that took place from the 1970s onwards which lay the groundwork for contemporary financialization. In Section 3 we deal directly with recent trends in financialization over the last thirty to forty years, focusing on changes to the functioning and priorities of non-financial corporations, the financialization of the household through debt and changes to commercial banking, and transformation in the business of financial institutions. Section 4 briefly considers the consequences of financialization with particular relation to the recent financial crisis. Section 5 concludes.[8]

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[6] Paulo L. dos Santos, "Production and Consumption Credit in a Continuous-Time Model of the Circuit of Capital," (Manuscript: SOAS, University of London, 2010).

[7] Section 1 has been significantly abbreviated from the original for this publication and focuses here predominately on rise of the credit system. For a fuller exposition of Marxian approaches to money and finance Makoto Itoh and Costas Lapavitsas, *The Political Economy of Money and Finance* (New York: St. Martin's Press, 1999), is recommended.

[8] Financialization is a global phenomenon, but has developed differently in distinct locations. Much of the literature is biased towards the United States, Western Europe and East Asia, and this paper suffers from that weakness. This paper focuses predominately on the United States, which, in many respects, represents the most extreme forms of financialization. Conclusions, therefore, should not be immediately generalized. However, because of the US'

1. Historical and Theoretical Basis

1.1. The Credit System

The dominant role of finance is not without precedent in the history of capitalism; in particular, the framework of modern finance emerged at the end of 19th century. Until this point the predominant forms of financial transactions had been usurious lending generally to wealthy landowners and small producers, loans to governments and the extension of commercial credit, promises to pay, and between productive capitalists.[9] There are important differences between usury and the capitalist credit system. Usury is inherently predatory and destroys its own basis by the charging of exorbitant interest which eventually eats into the property of the debtor or results in the appropriation of that property by the moneylender. Moreover, it remains external to "the core of social reproduction of precapitalist societies."[10] The fundamental reason for the predatory nature and external relation is that there was no systemic basis for the self-expansion of value prior to the ascension of capitalism. Usury serves, therefore, to expropriate from the worker his very means of labor and undermine feudal property ownership; these are not the results toward which "the capitalist mode of production tends, but rather the given presuppositions from which

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dominant role in the global economy and the trends in other developed countries in a similar direction this avenue of inquiry is both important and fruitful.

[9] Other forms of financial transactions did predate the end of the 19th century, loans to enterprise and currency trading exist under the Genoese regime, and joint-stock companies and a fully functioning twenty four hour stock exchange including speculative activity were established in the United Provinces in the early 17th century and in England at the end of the 17th century. However, these enterprises were different in a number of important ways, some mentioned above, to which the centrality of the state in commercial activities should be added. It is also debatable whether these can be considered fully-fledged capitalist enterprises as the capitalist mode of production and distinctly capitalist social relations had not become generalized. For a discussion on this thorny question see: Paul M. Sweezy, *The Transition from Feudalism to Capitalism* (London: NLB ; Atlantic Highlands N.J.: Humanities Press, 1976) and T. H Aston and C. H. E Philpin, *The Brenner Debate* (New York: Cambridge University Press, 1985). For a history of earlier periods of financial surges see Giovanni Arrighi, *The long twentieth century: money, power, and the origins of our times* (New York: Verso, 2010). This work is theoretically problematic for a number of reasons one of which is its ambiguity towards the aforementioned issue of theorizing the origins of capitalism.

[10] Itoh and Lapavitsas, *The Political Economy of Money and Finance,* 73.

it proceeds."[11]

Nevertheless usury shares with the modern capitalist economy a changed relationship of exchange where money serves to beget more money, under capitalism first through commodity exchange (M-C-M') and later through the direct extension of credit (M-M'). What changes is not the nature of capital itself but "the changed conditions under which it functions, and hence also the totally transformed figure of the borrower who confronts the money-lender."[12]

Early commercial credit was inherently severely limited; it was generally undertaken between capitalists who knew each other or worked in the same industry, the sums of money were not useful beyond a certain point in the chain, and the acceptability of such notes was not widespread.[13] This led to banking credit that began by the discounting of bills of exchange and the extension of short-term loans.[14] All of these forms were essential to cotton manufacturing of the early nineteenth century.

The growth of both industry and banking has occurred in tandem. As the sphere of lending increased so banks grew[15] and the money market emerged as a rediscount market for banks and an efficient mechanism for the regular settlement of matured commercial and bankers bills.[16] The centralization and concentration of industrial capital[17] went hand in hand with the extension and

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[11] Karl Marx, *Capital Volume III* (London: Penguin Books, 1981), 730.
[12] Ibid., 735.
[13] Ibid., 91.
[14] In explaining the rise of banking credit Marx makes a stylized distinction between "productive" and "money" capitalists (or financial and industrial capital). Marx uses this distinction continuously but critics of this simplification fail to see it for what it is: an abstraction and explanatory device. Marx uses such reductions elsewhere in his writings only to admit to their inapplicability and expand the nuances later. Whilst in some ways this division is representative of a qualitatively different function of different owners of capital, Marx notes that it is 'quite absurd' to apply this to 'the whole social capital', and there are many instances where even on the individual level the distinction is not absolute, e.g. where industrial capitalists loan money, this distinction has become increasingly obscured in the last thirty years. Marx, *Capital Volume III,* 501.
[15] With the growth of banks emerges a class of managers, a financial aristocracy, which occupies an ambiguous position in the capitalist mode of production.
[16] Itoh and Lapavitsas, *The Political Economy of Money and Finance,* 97.
[17] The concentration of capital refers to the growth of individual capitals whereas centralization refers to 'the attraction of capital to capital', the merging of existing capitals. Marx, *Capital Volume I,* 777.

centralization of financial capital through the banking system. As Marx notes: "The world would still be without railways if it had had to wait until accumulation had got a few individual capitals far enough to be adequate for the construction of a railway. Centralization, however, accomplished this . . . by means of joint-stock companies."[18] These joint-stock companies, being impossible without the credit system, required both substantial loans and the issuing of shares.[19]

The issuing of credit had always only partly relied on the reissuing of temporarily idle money capital amassed in money hoards.[20] Credit is also issued by the financial system preceding receipt of deposits. In other words, in generating loans, the financial sector is literally creating money based not only on actual deposits but expectations of future returns. This process of credit expansion is crucial to continued accumulation of capital and growth.[21] Not all credit is the same however; credit for investment in productive enterprise plays a double stimulatory effect serving to purchase raw material and, through production, boost future output and generate future pools of idle value. Credit for consumption serves only one function, to increase effective

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[18] Marx, *Capital Volume I,* 780.

[19] Despite the temptation, shares should not be seen as direct ownership of the industrial capital of the firm but rather are a form of, what Marx calls, *fictitious capital*. They are paper-claims to wealth that exist alongside the actual means of production and the value of shares issued often exceeds that of sunken capital. Further, shares lay claim to future wealth, to streams of future income; the firm, for example, provides these through profit revenue, the state through future tax receipts. As these are traded (many times over) as if they were that wealth itself, a collective illusion develops as to the source of these revenues; they represent neither direct ownership of the firm, nor are they completely free-floating assets whose continual expansion in value can be viable if unrelated to the material economy.

The notion of fictitious capital as used by Marx and others is not unproblematic. Ownership of stocks, for example must be understood as both a claim to a certain portion of dividends declared by the company from its profits, as well as a pro-rata share of the net assets of the company upon liquidation. These stocks can also be sold thus are realizable (or exchangeable) for money capital, in this sense it is difficult to see how the capital value can be said to be "fictitious". Without engaging this point in great depth, what is useful to take from Marx's discussion of fictitious capital has been laid out above, that we must consider these paper-claims not as representing direct ownership of industrial capital but as claims on future streams of income, the expected robustness of which determines their market price (and possibly, contrary to Marx, as a form of money capital upon sale or liquidation of the enterprise).

[20] These money hoards were typically constituted by: reserve funds to meet unforeseen payments and purchases (i.e. in the sphere of circulation); depreciation funds associated with fixed capital (i.e. in the sphere of production); and profits temporarily idle and available for reinvestment. Itoh and Lapavitsas, *The Political Economy of Money and Finance,* 67-69.

[21] This is postulated in Marx's analysis of the circuit of capital in Volume II of *Capital* and is well modeled and explained in Duncan Foley, "Realization and Accumulation in a Marxian Model of the Circuit of Capital," in *Journal of Economic Theory 28,* (1982).

demand and commodities purchases.

It is important to emphasize that debt does not involve the creation of value but rather the transfer of value, already realized in the form of money, from one agent to another. From the point of view of the lender the loan represents value created and realized in the past, from the point of view of the borrower it represents value it anticipates to receive in the future.[22] The payment of interest in each case, therefore, has its own logic. In industry the credit system accelerates the accumulation of total social capital by transforming idle money into industrial capital in motion, either by increasing turnover or allowing for investment in new technology or industries. Simultaneously one cost of circulation, money itself, is reduced and thus a further increase in total surplus value extracted occurs. Credit also allows for the reallocation of capital and productive resources across industries in the direction of the more profitable industries, thus promoting the equalization of the rate of profit.[23] All of this is more appropriately achieved through a centralized credit system and it is for this reason that the cost each industrial capitalist pays, in both interest and fees, is rational.[24] The logic behind interest premised on government or household debt is somewhat different. Governments may borrow to engage in productive activity but also do so to spend in a manner more similar to the consumption expenditure of households. The impact of such debt forms an integral part of the coming discussion, but that such debt is facilitated (indeed imposed) by the growth of the financial system is beyond doubt.

1.2. The Rise of Finance Capital

It has already been noted that the end of the 19th century saw finance rise to a dominant role in the capitalist economy. On the back of the credit system described above, finance proliferated in

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[22] Foley, "Realization and Accumulation in a Marxian Model of the Circuit of Capital," 310.
[23] Marx, *Capital Volume III,* 566-573.
[24] Itoh and Lapavitsas, *The Political Economy of Money and Finance,* 94-95.

a number of ways. Despite a number of theoretical weaknesses and historical divergences this process was well theorized by Rudolf Hilferding in *Finance Capital,* published in German in 1910, which offers a number of useful historical and theoretical perspectives that help us understand aspects of contemporary capitalism and the process of financialization.[25]

Two processes stand out. The first is the "corporate revolution," which saw the growth of industrial enterprises through the creation of joint-stock companies leading to large (often monopolistic) corporations backed and controlled by finance. What gave finance its power was its control over credit mechanisms and thus the money supply, and the increasing reliance on financial institutions, which took the leading role in floating shares on the stock market for investment finance. This brought financial institutions and industrial enterprise together and the former began to collect information on and monitor the enterprises to which they lent. This led to a contradictory movement where the socialization of capital through diffuse ownership of stocks took place, and yet because financial institutions mediated that ownership, or were the largest single organized shareholder, this simultaneously allowed them to centralize authority in new ways with profoundly beneficial consequences.

What follows is a separation of ownership from control, the second process often called the "managerial revolution," whereby the functions of the 'active capitalist' became delegated to a new managerial class of salaried workers. This in turn created new hierarchies of wage earners

[25] Rudolf Hilferding, *Finance Capital* (London: Routledge, 1981). The following criticisms should be noted. *Finance Capital* suffers from the analysis taking place at a high level of abstraction, and yet grounded specifically in German capitalism of the time, and thus makes generalizations which are empirically unfounded and historically flawed. Largely absent from the theoretical base of the book is an analysis of production, the labor process and the labor market, although the work should be read against *Capital*. The basic conceptualization of money and 'the necessity of money' lacks the logical coherence of Marx's original argument. More specifically the relative power of finance is exaggerated vis-à-vis the supposed subjugation of enterprise to financiers and the role it is argued to play in imperialism. Further the notion of "founder's profit" cannot be sustained as is, and world money is largely ignored. See Costas Lapavitsas, "Introduction to Hilferding's 'Finance Capital'," (Manuscript: SOAS, University of London, 2006). With limited space, many important aspects of *Finance-Capital* are not discussed here.

within the firm.[26]

The turn of the century therefore saw a shift in micro and macroeconomic structures and the concomitant social relations. The "corporate revolution" brought to the fore a shift in the social and power relations between industrial and financial capital. The "managerial revolution" was characterized by a shift within the firm towards new corporate structures and managerial arrangements, which led to an alternation in relations between capital and labor and a transmutation in the relation between capital – particularly finance and industrial capital – on the level of society as a whole. In certain ways this reflects transitions that have taken place within contemporary capitalism.[27]

For Hilferding, this process together with the centralization of both industrial and banking capital, and the dominance of the latter over the former, represent a secular tendency of maturing capitalism. Hilferding's full theory in its original form does not squarely fit subsequent developments; monopolies of the nature described have failed to gain hegemonic control and finance has not come to dominate industry in the manner he postulated. Nevertheless two strengths stand out. First, Hilferding "seeks the causes of the great transformation of his time in the fundamental relations of accumulation, rather than in policy or institutional change."[28] Second, it is clear that Hilferding, like Marx, whilst distinguishing different forms in which capital appears, provides an integrated theory rejecting a rigid separation of the real from the monetary that characterized so much orthodox economic theory before and after. This means that both industrial and financial capital have an interest in the profitability of the other, and that the

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[26] Duménil and Lévy, "Costs and Benefits of Neoliberalism," 20.
[27] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 101-102; Lapavitsas, "Introduction to Hilferding's 'Finance Capital'," 18; and Gérard Duménil and Dominique Lévy, "Periodizing capitalism. Technology, institutions, and relations of production", in *Phases of Capitalist Development: Booms, Crises, and Globalization*, ed. Robert Albritton (London: Palgrave 2001), 145-146 and 152-153.
[28] Ibid., 102.

growth of finance is endogenous to the process of capitalist development.

2. Capitalism, Finance and Changes in the Twentieth Century

2.1. From Hilferding to Neoliberalism

To recap, at the turn of the century the role of finance went through an historic transformation, from providing short-term credit to keep the wheels of trade and industry turning and long-term credit to governments and companies for large capital investment (e.g. railroads), to playing an active supervisory role in industry and a prime mover of the concentration and centralization processes. Joint-stock companies, mergers, price fixing and tendencies towards monopoly epitomize this concentration and centralization;[29] this allowed for new organizational structures, assembly lines, and greater efficiency. It also resulted in changes in the social relations between capitals and the separation of ownership from management. This process must be seen in the light of two crucial developments.

The first is the excessive expansion of industry and declining rates of profit in all advanced capitalist economies. At the opening of the twentieth century, growth was sluggish[30] but depressive tendencies were forestalled by the onset of the First World War and a number of subsequent factors including the first surge of the automobile industry and its ripple effects.[31]

The second is the control of finance in private hands – with finance remaining in control of its own institutions, particularly concerning the issuance of money, price stability and the functioning of the financial system itself – with little government regulation. During this time the expansion of the money supply, from less than a third of output in 1880 to more than two thirds

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[29] Duménil and Lévy, "Periodizing capitalism. Technology, institutions, and relations of production," 145-146; and Paul M. Sweezy, "The Triumph of Financial Capital," in *Monthly Review 46, no. 2* (1994): 2-3.
[30] Sweezy, "The Triumph of Financial Capital," 4; and see Duménil and Lévy, "Periodizing capitalism. Technology, institutions, and relations of production" for a graphical representation of declining profit rates.
[31] Sweezy, "The Triumph of Financial Capital".

in the 1920s (where it has remained at approximately the same level since) and the proliferation of financial mechanisms was spectacular.[32] This was also a period of increasing financial speculation and the instability that such speculation brings.

These two processes culminated in the financial crash of 1929 and the subsequent Great Depression, both of which unsettled this social order and set the scene in important ways for the next four decades. Out of the Great Depression, the New Deal, and the recovery largely attributable to the state-led economy (in the US) of World War II emerged the "Keynesian compromise," which held sway until the 1970s. Defining features of this period include: the suppression of the power of finance, a rise in the power of labor and an increase in their purchasing power, the acceptance of unions as important partners in the management of the new social order, the formalization of the welfare state, state intervention with regards to education and scientific research including the rise of the military-industrial complex, and in some countries, the direct involvement in the state in parts of the productive system.[33]

After the war the American economy was boosted by the massive investment needed to rebuild Europe, increased expenditure on wars (both hot and cold), and the 'industrialization' of agriculture. During this period other economies recovered (the rebuilding of their own national economies providing plentiful opportunity for investment), most importantly Germany and Japan, which set the stage for future developments. As is well documented, the boom years of the mid 1940s to the late 1960s saw a new "golden age" of capitalism. The 1950s and early 1960s especially were typified by extremely favorable conditions for capital accumulation. The 1960s, however, saw the profit rates decline, accumulation slow down, and tensions between labor, firms and finance exacerbated, leading eventually to the structural crisis and inflation of

[32] Gérard Duménil and Dominique Lévy, *Capital Resurgent* (Cambridge: Harvard University Press, 2004), 157; and Duménil and Lévy, "Costs and Benefits of Neoliberalism," 22-23.
[33] Duménil and Lévy, "Periodizing Capitalism. Technology, Institutions, and Relations of Production," 147.

the 1970s.[34]

As noted above, until the Great Depression the stability of financial institutions was largely in the hands of private institutions. Their inability to cope with the Depression, however, led the government to take a more active role. What emerged for the next half century was a relatively suppressed role of finance in the economy.[35] Finance, never fully accepting this defeat, spent these years actively "building a new international framework at a distance from domestic regulations,"[36] particularly in the Euromarkets. It first reasserted itself in the important role Wall Street played in the conglomeration mania of the 1960s that saw waves of mergers and acquisition, much like the processes described by Hilferding at the turn of the century. By the 1970s, the combined interests of multinational corporations, the US government and financial institutions spurred the neoliberal revolution and set the scene for the reemergence of the power of finance.

2.2. Roots of Financialization in the 1970s and the Rise of Neoliberalism

The rise of neoliberalism is characterized by a number of interlocking processes and interests that are crucial to our exposition here. Fundamentally, they are responses to the structural crisis of the 1970s, the recessions of 1974-5 and 1980-2, declining profitability, excess-capacity, and accumulation of huge amounts of capital. As with capitalism in general, the economic strategies to which these led are motivated by an unceasing quest for profit. Changes have taken place both in the relations and techniques of production and in the institutional and legal framework, which supports capitalist accumulation, as well as in social relations amongst key economic entities.[37]

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[34] Ibid., 148.
[35] Once again national variations are significant.
[36] Ibid., 147.
[37] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 101.

Most important amongst these processes are the brutal suppression of labor and the subsequent stagnation (or decline) in real wages, and the reduction in social programs; the breakdown of the Bretton Wood system leading to floating exchange rates, increased capital mobility, and higher interest rates; broad financial deregulation; privatization, in particular of social services such as pensions, healthcare, education and housing; changes in the emphasis of monetary policy; the outcome of conglomeration of the 1960s; renewed global competition; outsourcing and changes in the corporate form, and the advent of new technologies.[38]

All of the above must be understood to have taken place, arguably precipitated by declining rates of profit, on the back of over-capacity and increased global competition in the non-financial corporate economy – particularly in manufacturing – of the advanced capitalist countries.[39] An inevitable response from capital to declining profitability will be the attempt to increase the rate of exploitation. Such wage compression was characterized, in the neoliberal period, by five predominate features: geographic relocation of production, expansion of the reserve army, increased labor productivity, increase in work-hours, union-busting and the reduction of social benefits. In the United States this has seen the proportion of GDP spent on wages and salaries decline from above 53 percent in 1970 to below 46 percent in 2005, the real wages of nonagricultural workers in the United States were higher in 1972 at $8.99 than in 2006 at $8.24.[40] This has led to a reduction in the living standards of most wage earners whilst concentrating wealth in a tiny proportion of the population.

The breakdown of the Bretton Wood system led to greater capital mobility and floating exchange rates. The end of dollar-gold convertibility in 1971 saw the dollar emerge as

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[38] As noted in the introduction this paper suffers from an American and Euro-centric approach. The role of foreign direct investment and developing markets is largely not considered in this paper.
[39] See Robert Brenner, *The Boom and the Bubble*, (New York: Verso, 2002).
[40] John B. Foster and Fred Magdoff, *The Great Financial Crisis* (New York: Monthly Review Press, 2009), 129.

international credit-money, which grounded the US national debt and caused currency values to become increasingly volatile. This created fertile ground for foreign exchange trading, risk hedging and speculation, which are discussed below.[41]

Inflation in the 1970s began to erode the savings that Americans had accumulated in the post war era. Wall Street responded by seeking higher-yields through increasing trading in financial securities rather than investing in productive assets.[42] Tight banking regulation limited the options of commercial banks, as money-market funds were able to offer savers higher rates of return. Both these factors led to broad deregulation of the financial sector, with banks now able to invest in higher-yield and riskier assets.[43] This meant removing controls on interest rates and the quantity of credit that could be advanced, establishing and promoting new capital markets, removing non-competitive practices among money market brokers, dismantling controls on international flows of capital, and so on.[44] A defining moment was the change in monetary policy in 1979 focusing monetary policy almost exclusively on price stability (abandoning full employment and decent wages as economic priorities) and introducing high interest rates, both profoundly beneficial to finance. The role of the state thus became central, with finance coming to dominate the originally Keynesian institutions of an expanded state apparatus.[45] At the same time, the privatization of various social benefits (pensions, medical care, etc.) meant the entry into the market of new institutional investors such as pension funds, trading in financial assets and purchasing equity in non-financial corporations.

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[41] McNally, "From Financial Crisis to World-Slump: Accumulation, Financialisation, and the Global Slowdown," 57-58.

[42] William Lazonick, "Marketization, Globalization, Financialization: The Fragility of the US Economy in an Era of Global Change" (paper presented at Business History Conference, March 2010): 25.

[43] William Lazonick and Mary O'Sullivan, "Maximizing Shareholder Value: a New Ideology for Corporate Governance," in *Economy and Society Volume 29, Number 1,* (2000), 16-17.

[44] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 107.

[45] Duménil and Lévy, *Capital Resurgent,* 157; and Duménil and Lévy, "Costs and Benefits of Neoliberalism," 25.

As mentioned above, the 1960s had seen the conglomeration of many companies; however, by the 1970s the failure of such unrelated diversification became apparent. At the same time renewed global competition, due in large part to the recovery of Japan and Germany, the growth of East Asian economies and the growth of new MNCs ranging from Brazil to Malaysia, placed further pressure on profit rates. Combined, these led to the hostile takeover movement of the 1980s and the subsequent issuing of junk bonds, leading to a new strategy of downsizing and outsourcing. This saw a greater internationalization of the division of labor, and the dissolution of the vertical structures of many corporations – traditionally with their own internal supply chains and long-term secure job tenure – a rapid outsourcing of key components of their work, and changes in the composition and location of their workforce.

Taking place alongside and interacting with all these processes (which by no means should be viewed in isolation from one another) was the growth in new technologies, particularly the IT revolution. This has had important consequences for both the spheres of production and circulation. New techniques in production made possible labor-saving and the suppression of wages, as well as internationalization of operations. These, however, have not managed to stave off a general trend of falling growth rates since the 1970s.[46] In the sphere of circulation these technologies, particularly in computing and communication, have made possible the huge trade in financial assets and much of the financialization described below.[47]

I have described very broadly here changes occurring since the early 1970s but it would be incorrect to characterize the period that follows as homogenous. Further, it would be a mistake to view it as one of steady stagnation, crisis or downturn. McNally argues that one should instead see it as having three rough phases: a period of crisis and declining profitability from 1973 to

[46] Here geographical considerations are of importance. Whilst previously industrialized countries have certainly seen indifferent productive performance emerging economies such as China and India have seen huge booms.
[47] Ibid., 104-105.

1982 (rooted in declining profitability emerging before this); a period of sustained recovery, real accumulation and increased profit rates (albeit not at the levels of the 1950s and 1960s) from 1982 – 1996/7,[48] then a period (1997 onwards) of accumulation sustained only by gargantuan credit-expansion.[49] One must beware of the temptation to use the boom era as a benchmark – the volatility of the last four decades has reestablished capitalist patterns of accumulation, instability and crises. Since it is instead an anomaly, the boom era warrants explanation.

3. Financialization

It is worth pausing to note a theoretical point before proceeding. The rise of finance has sometimes been depicted as leading to an "inverted relation between the financial and the real;"[50] such a statement is misleading. The quantitative change in the predominant proprietary form in which entitlements to wealth are held does not mean an *inversion in the relationship* between the financial and the real with value creation still exclusively taking place in the latter. It is precisely the dynamic of this relationship that is at issue here and, as stated in the introduction, the changes this has caused in the relationship between industrial and finance capital, and between capital and labor. On the back of the processes described above, the search for profitability, and thus investment, has shifted from the sphere of production to the sphere of circulation. This is fundamentally the result of over-capacity, increased international competition and declining rates of profit in the non-financial corporate global economy, particularly manufacturing, and the need for profitable avenues of investment of surplus capital. Together with this, various government

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[48] McNally claims this is sustained by the data from a number of authors including Mohun, Moseley, Wolff, Duménil and Lévy, Husson, and Brenner. McNally, "From Financial Crisis to World-Slump: Accumulation, Financialisation, and the Global Slowdown," 49. Others divide the time periods slightly differently but the general trend of: crises and declining profitability, boom and partial recovery, and declining profitability with huge credit expansion, is shared. See Duménil and Lévy, "Costs and Benefits of Neoliberalism," 25-27; and Brenner, *The Boom and the Bubble.*

[49] Once again geographic specificity is needed, however, these periods refer roughly to the global economy.

[50] Sweezy, "The Triumph of Financial Capital," 8-10.

regulatory policies have developed that promoted access to credit, ostensibly to spur corporate investment, and deliberately encourage the inflation of paper assets (first stocks and then home values) generating a "wealth effect" (increasingly divorced from actual productivity and profit) that allowed for the maintenance of effective demand through investment and household consumption.[51] The ensuing phenomenon of financialization can be seen in at least three significant ways: in the increasing participation of non-financial firms in financial markets, with the explosion of household debt and the trading of this debt, and transformations in the nature of operations of financial institutions. These are discussed below.

3.1. Industrial Capital and Finance

As mentioned above the last thirty years has seen the dual (apparently contradictory) processes of the increased global competition across increasingly deregulated global markets on the one hand, and on the other hand the emergence of huge multinational corporations dominating the global market. Contrary to Hilferding's analysis, this has not led to the direct control of finance over these industries, nor as Sweezy maintained have we entered the era of monopoly capitalism. Instead the financialization of industry has taken place in different ways.

Over the last half of the twentieth century industry predominately managed to finance its own expansion through retention of its own profits. This was already observed by Sweezy in the 1940s[52] and has been born out in a number of empirical studies. Corbett and Jenkinson, for example, found that in Germany, Japan, the UK, and the US, internal investment accounted for 78.9, 69.9, 93.3, and 96.1 percents, respectively, of net sources of investment between 1970 and

[51] Brenner, *The Boom and the Bubble.*
[52] Paul M. Sweezy, *The Theory of Capitalist Development* (New York: Monthly Review Press, 1942), 267.

1994.[53] This has to do with the huge revenues these corporations earned during the boom years, the internal organization of the MNC, the types of technology that prevailed post WWII, and particular government support to industry (largely in research and development, infrastructure and indirectly through the provision of social services). This, naturally, has meant a declining reliance on banks compared with the process at the end of the 19th century as described by Hilferding, although banks have continued to play a more basic role by extending short-term capital to allow for immediate payments. When corporate enterprise has needed external finance it has increasingly turned directly to the markets most notably through the issue of bonds and stocks; the issuance of such corporate liabilities grew from a postwar average of four percent of GDP to over 30 percent in 2001.[54] As Brenner notes about the economic boom of the late 1990s: "[n]ever before in US history had the stock market played such a direct, and decisive, role in financing non-financial corporations, and thereby powering the growth of capital expenditures and in this way the real economy. Never before had a US economic expansion become so dependent upon the stock market's ascent."[55]

Large corporations, in possession of temporary idle capital, have also engaged the markets as lenders and engaged in trading in equities and other financial instruments.[56] In addition these corporations engage in consumer lending through the issuances of store-credit and credit cards

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[53] Jenny Corbett and Tim Jenkinson, "How is Investment Financed? A Study of Germany, Japan, the United Kingdom and the United States," in *Papers in Money, Macroeconomics and Finance, The Manchester School Supplement,* LXV. (1997): 74. See also: Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 102; Paulo L. dos Santos, "On the Content of Banking in Contemporary Capitalism" in *Historical Materialism* 17 (2009): 6; and
Lazonick and O'Sullivan, "Maximizing Shareholder Value: a New Ideology for Corporate Governance," 14.

[54] dos Santos, "On the Content of Banking in Contemporary Capitalism," 7. The data from Corbett and Jenkinson shows that by 1994 only in the US had bonds played a more substantive role than banking credit. Whilst significant geographical difference exists the trend away from bank finance is perhaps best represented by Japan, the quintessential bank-based system, which has seen bank finance decrease from 42.7 percent in 1970-74 to 19.5 in 1990-94. There is no reason to assume this trend has not persisted. Corbett and Jenkinson, "How is Investment Financed? A Study of Germany, Japan, the United Kingdom and the United States," 81.

[55] Brenner, *The Boom and the Bubble,*195.

[56] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 108.

and diversifying into fields such as providing mortgages. General Motors for example whilst having trouble selling cars, its ditch.com mortgage business earned $2.9 billion in 2005.[57]

Non-financial corporations have also seen changes in priorities and internal organization (often hand-in-hand with one another). Much has been written about the "shareholder revolution" which has seen corporate management shift its focus from the generation of profit to maintaining high stock prices, what has been termed "shareholder value." This has seen a shift from a strategy of "retain-and-invest" to "downsize-and-distribute." This process was spurred by a range of factors mostly described above: US corporations growing too large—becoming centralized and diversified for effective management, the rise of Japanese and other competition, the growth of new institutional investors (e.g. pension funds), and declining profits. It is argued that two changes, "the development of new financial instruments that allowed hostile takeovers and changes in the pay structure of managers," have had a decisive role, with the former playing "the role of the stick, the latter are the carrot."[58]

The trend of "downsize-and-distribute" is clear, with downsizing evident in the labor market for both white and blue collar workers and other aspects of restructuring already discussed in section 2.2.[59] With regards to "distribute" the huge jump in dividend payouts as a proportion of after tax corporate profit tells the story; averaging relatively stable per decade in the 1950s, 1960s, and 1970s at 47.9, 42.4, and 42.3 percents, respectively, and then rising to 48.9 percent in the 1980s, 55.0 percent in the 1990s, and 61.5 percent between 2000 and 2009 peaking

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[57] Foster and Magdoff, *The Great Financial Crisis,* 54.
[58] Engelbert Stockhammer, "Financialisation and the Slowdown of Accumulation," in *Cambridge Journal of Economics No. 28,* (2004): 726.
[59] For an exposition of the job losses as a result of restructuring see Lazonick, "Marketization, Globalization, Financialization: The Fragility of the US Economy in an Era of Global Change" and Lazonick and O'Sullivan, "Maximizing Shareholder Value: a New Ideology for Corporate Governance". A word of caution should be added that whilst jobs have been lost in the US and other developed economies they have been created (albeit at far lower cost) in many areas of the developing world.

at 70.4 percent in 2007.[60]

The key mechanism for maintaining stock prices has been stock repurchases that have skyrocketed over the last thirty years. Data on 373 companies in the S&P 500 Index shows an increase in buybacks from $25.9 billion in 1990-1994 representing 23 percent of combined net income, to $106.3 billion in 1995-1999 representing 44 percent of combined net income. By 2007 the combined 500 companies of the S&P Index in January 2008 spent $549 billion on stock repurchases, a whopping 94 percent of their net income. In addition, many of these purchases of equity were done with borrowed money, leading to the historically highest levels of corporate indebtedness.[61] It is clear that these repurchases were fundamental to the meteoric rise of the stock market.[62] Companies often claim this is done to offset dilution from their stock-option programs but the scope of repurchases is well in excess of the number of stock options exercised. They also argue that it is done to signal confidence in the future of the company and its stock-price performance but companies that do buybacks have not been seen to sell the shares at higher prices to cash in on these investments.[63] Most of the shareholder-value literature emphasizes the enormous personal gain made by corporate executives in following this strategy because of the restructuring of salaries that has seen them receive massive stock options. Considering this the primary factor should be viewed with caution both theoretically – by placing the actions of a managerial class at the center of analysis – and empirically.[64] More importantly questions should be raised about the directors of companies and institutional stockholders who

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[60] Lazonick and O'Sullivan, "Maximizing Shareholder Value: a New Ideology for Corporate Governance," 22.
[61] Brenner, *The Boom and the Bubble,* 192-195.
[62] Lazonick, "Marketization, Globalization, Financialization: The Fragility of the US Economy in an Era of Global Change," 28-29.
[63] *Ibid.* 30.
[64] The data does show that top executive salaries soared in relation to workers (for the 200 largest US corporation from 42:1 in 1980 to 319:1 in 2008) but the percent of income through cashing in on stocks over the last two decades (ranging between 57 percent to 87 percent) has moved in tandem with stock market fluctuations and has not demonstrated a constant upwards trend, e.g. it was 71 percent in 1992, 57 percent in 1994, 87 percent in 2000 and went down to 62 percent in 2008 (see table 4). *Ibid.* 31.

are prepared to reward management so handsomely for these actions.

What then can be said about the financialization of industrial capital? Despite less reliance on banks, corporations have been more heavily involved in financial activities, through leveraging, lending and trading of capital in financial markets, lending to consumers, and a corporate policy focus on maintaining high stock prices. What is abundantly clear is that both profits and money raised have not been reinvested in productive capacity. Between 1984 and 2009 the net fixed investment of US non-financial corporations fell to 17.7 percent of profits from 23.7 percent in the preceding 25 years (1969 – 1984).[65] Financial transactions have therefore become a substantial part of their activities and profit making. This represents a shift in the relative priority these firms have given to the realization of value in the spheres of production and circulation.

This speaks to a shift in social relations. The turn of the century saw the separation of ownership from control and the balance of power shift from industrial to financial capital, together with this emerged a managerial class doing the bidding of the latter. From the Great Depression to the early 1970s there was an increase in the autonomy of management and a compromise made with workers. The reassertion of the power of finance under neoliberalism has seen the brutal dissolution of this compromise and a reduction in the autonomy of management. Management still occupies a powerful yet ambiguous position (perhaps more critical than ever before), part owners of capital, part salaried personnel serving as both "workers" and the functioning arm of capital.

[65] dos Santos, "On the Content of Banking in Contemporary Capitalism," 8.

3.2. The Financialization of Workers' Wages

The United States and elsewhere has seen a massive expansion in debt. In America, the total debt grew from $1.5 trillion in 1970 to $47.7 trillion in 2007, representing an increase from 150 percent of GDP that stood at $1.0 trillion to 345.7 percent of GDP at $13.8 trillion.[66] Just under a third of this was household debt, which, in 2007, exceeded the disposable income of households by 27 percent.[67] The debt burden has been disproportionately borne by low-income, working-class families, with mean household debt to mean income in the US moving from 87.5 to 258.5 percent between 1989 and 2007 for the poorest 20 percent of the population and from only 60.2 to 86.7 percent for the wealthiest 10 percent.[68] Sustaining this debt has become ever more cumbersome with the amount of disposable income paid out as interest reaching a record 19.4 percent in 2007;[69] once again this burden is disproportionately carried by the poorest. The most fundamental factor in explaining this expansion of debt is the repression of real wages as part of the neoliberal shift as described in section 2.2.

Wage compression combined with the reduction of social benefits and the privatization of many essential services has meant households have increasingly come to rely on the market for these services, housing and pensions being two notable examples. We are all too familiar with the leap in the scope of mortgages and the ease of acquiring one. Further, the majority of these mortgages were used to refinance homes illustrating the use of houses as collateral for leveraging even more debt. The danger for mortgage holders is that as a liability mortgage debt is a fixed obligation, whereas as an asset it varies with the vagaries of the housing market, boosting

[66] Foster and Magdoff, *The Great Financial Crisis,* 121. In the US such debt is only sustainable through a significant current account deficit that itself has important consequences for global capitalism not considered here.
[67] Ibid., 29.
[68] Paulo L. dos Santos, "At The Heart of the Matter: Household Debt in Contemporary Banking and the International Crisis," in *Ekonomiaz* No. 72, Vol 3 (2009): 61.
[69] Ibid., 60.

consumption during boom years but limiting it and imposing impossible repayment requirements when the bubble bursts.[70] The trend of property bubbles emerging together with increases in household debt ratios can be seen in the USA, UK, Ireland and Spain.[71]

Debt has supported consumer spending in the face of stagnant or declining wages, indeed between 1994 and 2004 consumption grew faster than national income with the share of personal consumption as a percentage of GDP rising from 60 to 70 percent.[72] Banks, and other institutions, have been more than ready to provide this ever-expanding access to credit and this has profoundly changed the nature of contemporary banking and resulted in an important shift in their profits. There has been a reorganization within banks that illustrates an orientation towards individual credit with consumer funds becoming central to bank business. The importance of individual lending is well documented in a study of nine major international banks by Dos Santos with loans to individuals as high as 77.7 percent of total loans (for Citigroup, December 2006) and mortgages representing up to 73 percent of loans to individuals (for Barclays, December 2006).[73]

Banks have profited from this focus through the charging of fees, which have become a major source of bank revenue. For consumer lending these fees include overdraft charges, late payment fees, credit card charges, ATM transaction fees, in addition to phone and internet banking services, which have climbed as high as 33.8 percent of revenue share (for Bank of America, 2007).[74]

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[70] Lapavitsas, “Financialisation, of the Search for Profits in the Sphere of Circulation,” 111.
[71] Engelbert Stockhammer, “The Finance-Dominated Accumulation Regime, Income Distribution and the Present Crisis,” in *Depart of Economics Working Paper Series* (Vienna: Vienna University, 2009), 7.
[72] Foster and Magdoff, *The Great Financial Crisis,* 28.
[73] dos Santos, “On the Content of Banking in Contemporary Capitalism,” 11 and 13.
[74] dos Santos, “At The Heart of the Matter: Household Debt in Contemporary Banking and the International Crisis,” 14-15.

As noted above wage earnings have entered the financial markets in other ways, most importantly through the privatization and deregulation of pension and insurance funds. In the US pensions and mutual funds held by households exploded from a post-war average of around 40 percent of GDP to an average of 120-140 percent in the last ten years. Likewise Japan saw mutual fund holdings and insurance reserves (which include pension savings) rise from 21.8 percent of GDP in 1980 to 88.3 percent of GDP in 2005.[75] This has had a number of consequences. Pension funds and other institutional investors have emerged as important players in the financialization of non-financial corporations discussed above in section 3.1. Additionally banks have developed a new array of investment funds to cater to this market and the fees and commissions associated with these have played an important role in their profits, growing since 1980 to $11.8 billion in the US alone.[76]

The profitability of lending to wage-earning individuals is clear by the vigor with which banks have pursued this strategy.[77] The aggressive pursuit of this, especially in the low interest rate setting in the US in the 2000s, led banks to engage in predatory lending to those historically oppressed and excluded segments of the population. By its nature this lending bears a close semblance to early forms of usury and has a number of shared characteristics. First, the credit is not extended for a productive purpose, to play a role in the further valorization of capital but rather to sustain consumption (it is part of the C-M-C' chain not M-C-M'). Its repayments are, therefore, grounded in subsequent wages and represent value the borrowers have acquired separate to the loan.[78] Second, like usury, through the charging of unsustainable rates of interest

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[75] dos Santos, "On the Content of Banking in Contemporary Capitalism," 5 -7.
[76] See dos Santos, "On the Content of Banking in Contemporary Capitalism," 16-20; and dos Santos, "At The Heart of the Matter: Household Debt in Contemporary Banking and the International Crisis," 59.
[77] dos Santos, "At The Heart of the Matter: Household Debt in Contemporary Banking and the International Crisis," 62.
[78] Ibid., 68.

the creditor undermines the ability of future repayments (as illustrated through mortgage defaults). Third, this debt involves deep asymmetries of power in terms of 'information availability, economic and social power, and alternatives in undertaking transactions' with the profit-maximizing-lender facing ordinary wage earners attempting to acquire vital basic necessities.[79]

This lending is based on existing inequalities that serve to reproduce and extend them. Debt serves as a powerful tool for disciplining the working class; it allows workers to access necessary commodities, thus possibly undercutting labor mobilization, but only delays the date of payment when the eventual crunch will be felt. Often this credit-spurred expenditure is then cast as "irresponsible" and "poorly managed," with blame laid at the feet of the workers.[80] It has been necessitated by shortfalls of effective demand due to wage compression; the circuit of capital, described in section 1.4, cannot reproduce itself without this. The unfortunate irony is that capitalism, through its own internal dynamics, drains wealth from labor only to re-extend it through debt. This extension, and at times its writing-off, serves as an important redistributive function but on grossly unfavorable terms to the debtor. It also has particular consequences for the chances of recovery from financial crises as noted briefly in section 4. This type of lending has led to financialized relations between capital and labor in profoundly new ways, extending the direct control of capital beyond the workplace.

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[79] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 111. See also dos Santos, "On the Content of Banking in Contemporary Capitalism"; and dos Santos, "At The Heart of the Matter: Household Debt in Contemporary Banking and the International Crisis".

[80] Debt has also served to dispossess and control in a number of different ways: national debt of third world countries, corporate debt, IMF debt, and debt to small landowners and peasants to leverage people from their land. McNally, "From Financial Crisis to World-Slump: Accumulation, Financialisation, and the Global Slowdown," 73.

3.3. Changes in Financial Institutions and the Financial Market

Significant changes have taken place in the nature and structure of financial markets; this includes what assets are traded, how they are traded, for whom they are traded and by which institutions.

Three key developments have brought onto the market a proliferation of new financial products. First, on the side of non-financial corporations the hostile takeover movement of the 1980s saw the mass issuing of junk bonds and the creation of a liquid market for their purchase and sale.[81] Second, the abandonment of the gold standard, the move to floating exchange rates and deregulation of foreign exchange markets saw increasing volatility in currency values. Within this context the US dollar emerged as a fully-fledged international credit money grounded entirely in fictitious capital, and the US national debt, became fertile ground for speculation. By 2009 the average daily turnover in foreign exchange trading, now by far the world's largest market, reached $4 trillion, an 800 percent increase since 1988. Third, with increased uncertainty risk-assessment, hedging became crucial activities for all capitals, especially businesses whose operations require moving through multiple currencies. Thus the market for derivatives exploded. Whilst originally an instrument to hedge against legitimate risks in these volatile foreign exchange markets they soon became instruments to cover almost any conceivable risk, leading to derivative contracts that resemble nothing so much as financial gambling, the recent proliferation of credit default swaps being a case in point.[82]

The tremendous surge in this form of financial gambling comes not only on the back of

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[81] Lazonick and O'Sullivan, "Maximizing Shareholder Value: a New Ideology for Corporate Governance," 17.
[82] McNally, "From Financial Crisis to World-Slump: Accumulation, Financialisation, and the Global Slowdown," 57-58.

foreign exchange trading but within other markets.[83] Crucial to the current crisis is the trading and packaging of household debt. This has seen both reselling of that debt, for example in the form of mortgage-backed securities often through collateralized debt obligations (CDOs), and risk hedging derivative-contracts on those securities. Derivative-markets have by far eclipsed those of stocks and bonds; in 2006, for example, $450 trillion in derivative-contracts were sold compared with $40 trillion in global stock markets and $65 trillion in world bond markets. As has been seen when these CDOs are backed by assets whose rising values are unsustainable, and their holders unable to service the debt default, a collapse in the value of the CDO and the exercising of derivative-contracts can have a devastating effect.

Non-financial firms have made heavy use of derivate trading but financial intermediaries account for the vast majority of over-the-counter (OTC) derivative contracts.[84] Commercial banks have continued with conventional investment-banking functions such as "underwriting, brokerage and corporate advisory services" and have expanded into "investment- and insurance-fund management and into the issuance and dealing in derivate assets" on behalf of clients and in pursuit of capital gains on their own accounts;[85] for example six of the nine commercial banks studied by Dos Santos were among the top seven dealers of derivative assets worldwide.[86] Fund management has also become an increasingly important part of banks activities and profits, particularly as mutual fund holdings have expanded throughout the general population, notably as a result of pension-fund privatization, with the attendant social relations already discussed above. Similar to consumer debt, commission and fees charged on fund management account for an important part of revenue share, ranging from 1.6 percent to 17.7 percent for the banks

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[83] Derivative contracts on interest rate fluctuations have also played a substantive role. dos Santos, "On the Content of Banking in Contemporary Capitalism," 23.
[84] Ibid., 23.
[85] Ibid., 16.
[86] Ibid., 22.

studied.[87] These activities also offer the opportunity to make significant capital gains on securities involving banks in extensive propriety trading. In the nine traditional banks studied this accounted for between 6.4 percent and 41.7 percent of revenue.[88]

At the same time as non-financial corporations, commercial banks, and new institutional investors (such as pension funds) entered financial markets, the size and scope of activity of investment banks, hedge funds, private equity firms and the like saw increases. The focus of Wall Street financial firms has shifted from supporting long-term investment (largely through bond issues) to generating fees and capital gains by trading in a wide array of financial assets (some discussed above), often with little regulation or substantive oversight.[89] They have also drawn increasing investments from the general public, either directly or indirectly. Finally, as the recent market crash has demonstrated, the various financial institutions including commercial and investment banks have become intricately linked through a web of financial transactions, bets and hedges that is almost impossible to untangle. This, and indeed the entire financial sector, has been made possible by a social and professional network of corporate managers, individual investors and managers of institutional funds.[90]

All of the above has been facilitated by the advent of new technology that has favored such activity. The advances in computing have made it possible to handle enormous sums of money from a huge number of individual borrowers and vast amounts of data, as well as extremely complex models for pricing, risk management and the like. The speed of the Internet and telecommunications have made trading virtually instantaneous and tied financial markets closer together. These changes go to the root of the asymmetry between production and circulation;

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[87] Ibid., 18.
[88] Ibid., 21.
[89] Lazonick and O'Sullivan, "Maximizing Shareholder Value: a New Ideology for Corporate Governance," 16.
[90] dos Santos, "On the Content of Banking in Contemporary Capitalism," 27.

whilst productive growth has been sluggish, these technologies have allowed finance to advance in leaps and bounds.[91] This has increased the power of financial capital in other ways; for example, whereas before it would take months, if not years, for consumers to shift preferences and thus punish unfavorable companies, it now takes investors minutes to send a company into a tailspin, with such decisions based simply on expectations of future profits. Here, once again, we see a shift in power and social relations between capitals.

4. Possible Consequences

There can be little doubt that the current crisis, which erupted so aggressively in September of 2008, rose on the back of the process of financialization described here. When thinking about this crisis, and the recession the world still faces, one must keep in mind two important points. First, the crisis is not simply a crisis of irresponsible financial trading but is inextricable from the health of the productive economy, as is the shift in profit generation away from production towards circulation. Second, because of the processes of financialization this crisis has a number of distinctive features with important bearings on the chances for recovery. The first point cannot be addressed here and a few cursory comments will be made on the second following the order of our discussion above.

First, the greater participation of non-financial firms in the financial market has meant that any instability in financial markets is likely to affect productive enterprises in new and more direct ways. Second, this crisis is unique in that it originated neither in a crash in equity markets nor an industrial crisis, but was precipitated by working-class families in the United States defaulting on their mortgages, centering the importance of household debt.[92] The chances for,

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[91] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 106.
[92] dos Santos, "On the Content of Banking in Contemporary Capitalism," 1-2,

and process of, recovery are likewise unique. During classical industrial crises, the crisis lays the seeds for its own recovery. Capital is depreciated allowing for the destruction of unproductive capital, wages are reduced, corporate securities depreciate and falling equity prices allow for corporate takeovers and other types of mergers and acquisitions. This allows for the operation and financial restructuring of the productive enterprises that survive, laying the basis for a recovery in profitability and a new upswing in accumulation (as first described by Marx in *Capital Volume III*).[93]

The centrality of household indebtedness to the current crisis throws up new obstacles to recovery. The collapse of credit has led to staggering falls in consumption, which dropped by a record year-on-year 1.58 percent in the final quarter of 2008 despite the drastic reduction of interest rates by the Federal Reserve.[94] A reduction in consumption (where possible) is also a strategic choice by heavily indebted households, solvable only by an increase in real wages. However, both reduced consumption and increased wages stand opposed to a market-based recovery.[95] There is no mechanism for the restructuring of households similar to that of productive enterprise. A return to financial and economic stability will require the transfer of wealth from financial and productive capital to wage earners, which is unlikely to happen on market terms.[96] It should be remembered also, as laid out in section 1.4, that consumption credit, where extended, plays a less stimulatory role than credit for production.

Third, the centrality of investment-banking functions that came to characterize commercial banks played a substantial role in the rolling bankruptcy of these banks that has been witnessed across the developed world. One reason was the tension generated between solvency and

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[93] dos Santos, "At The Heart of the Matter: Household Debt in Contemporary Banking and the International Crisis," 70-72.
[94] Ibid., 73.
[95] Ibid., 74.
[96] Ibid., 75.

liquidity. Briefly put, some commercial banks shifted their liquidity, which originates in deposits, from secure, tradable assets to various securities. If these securities collapse (as the mortgage-backed securities did) their liquidity could dry up, potentially creating an inability to meet deposit withdrawal demand. Further, if they have reduced capital reserves as investment banks do, by moving assets off balance sheets whilst still holding ultimate responsibility for them, then their liquidity shortages could turn into a solvency problem and result in bankruptcy. This is precisely what happened.[97]

Fourth, all of this took place by the trading of increasingly riskier financial assets further and further removed from the real economy. With the detachment of capital-market prices from the underlying realities of accumulation, a general expectation of future security-price rises can itself lead to an increase in demand, yielding considerable profits that appear to validate expectations. In this way speculative bubbles emerge and eventually, when the value of that security cannot be substantiated in the real economy, bursts with devastating consequences.[98]

Conclusion

In this paper I have sketched a theoretical Marxian framework for understanding credit and finance. In doing so I distinguished between the spheres of production and circulation whilst maintaining the unity of the system as a whole. By viewing credit not only as a microeconomic transaction between different economic agents but also as endogenous to the circuit of capital one is able to understand the fundamental role that credit plays in reproducing the capitalist mode of production, and that positive growth and accumulation is impossible without it. Yet by tracing, on a more concrete level of analysis, the role of finance within the economy one is able

[97] Lapavitsas, "Financialisation, of the Search for Profits in the Sphere of Circulation," 113.
[98] dos Santos, "On the Content of Banking in Contemporary Capitalism," 26.

to clearly see the contradictions and instabilities that such financialization brings.

The nineteenth century brought the domination of industrial capitalists. At the turn of the twentieth century the power of finance capital grew, ownership was separated from control, and a corps of managers born. The years between the Great Depression and 1970s saw a compromise with workers, increased autonomy of managers, and finance subjugated but furtively reconstructing itself at the edges of the regulatory framework. Finance first forcefully reappeared in the conglomeration mania of the 1960s and then with neoliberalism's deregulation was it fully unleashed; subsequently workers, managers and the state have all been affected by its power. The financialization of the contemporary economy has progressed, however, in novel ways. Industry has become less reliant on banks but more involved in capital markets as both borrower and lender. The privatization of pension funds triggered unprecedented flows of lendable money into capital markets. Household debt has grown to staggering proportions. Commercial banks positioned themselves as financial market intermediaries and found new ways of appropriating wealth from households creating usurious and expropriating forms of lending. An array of financial instruments has proliferated resembling sophisticated forms of gambling. And all of this has been made possible by particular technology. Against this the productive economy has performed indifferently and so capital, disinterested as to the use-value of the asset it traded, has more and more sought profit through finance in the sphere of circulation. This led to new forms of instability that eventually manifested in an astronomical financial meltdown stopped only by the intervention of the state.

In the final analysis one must understand financialization as the financialization of the social relations between capitals and between capital and wage-labor. Industrial capital has entered into the financial realm, changing its own priorities and transforming relations between shareholders, directors and managers. At the same time the daily activities of workers have become financialized as they increasingly rely on credit and the market for daily necessities and long-term social goods. This has ceded enormous power to capital, as well as brought new institutional investors into the market. Finally, financial institutions and institutional investors have exerted new forms of control over industrial capital and the state, with both exhibiting heavy concern for how “the market” may react to its decisions. This paper has offered an initial overview of these theoretical and historic transformations.