Money, credit and finance

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3 Part Structure

- A. Marx on Money, Credit, finance and Crises
- B. The Global Financial Crisis
- C. An Unorthodox Marxian Explanation of the Crisis

A. Marx on Money, Credit, Finance and Crises

- i. Simple Commodity System
- ii. Capitalist commodity system
- iii. Capitalist crises.
- iv. The Business Cycle and Monetary Crises

Commodity

- Unity of use value and value
- Duality of value dimensions:

  value substance: social rule of price determination

  value form: decentralized mode of price formation

Role of Money

Price Formation =

- Price Assignment: money as measure of value

  and
- Price Realisation: money as medium of exchange

Abstract Possibility of Crisis

- Barter: C-C i.e. no general crisis possible
- Monetary Exchange System:

C-M...M-C

C..M...M..C

split between C and M make possible general crisis

The general abstract possibility of crisis denotes no more than the most abstract form of crisis, without content, without a compelling motivating factor. Sale and purchase may fall apart. They thus represent potential crisis and their coincidence always remains a critical factor for the commodity. The transition from one to the other may, however, proceed smoothly. The most abstract form of crisis (and therefore the form of possibility of crisis) is thus the metamorphosis of the commodity itself; the contradiction of exchange-value and use-value, and furthermore of money and commodity, comprised within the unity of the commodity, exists in metamorphosis only as an involved movement. The factors which turn this possibility of crisis into [an actual] crisis are not contained in this form itself; it only implies that the framework for a crisis exists.

Credit: Money as means of payment

Debt-contract relations:

Seller/creditor - Buyer/borrower - Final buyer

C (credit) $\longrightarrow$ C (debt) $\longrightarrow$ C

M $\longleftarrow$ M $\longleftarrow$ M

The seller sells an existing commodity, the buyer buys as the mere representative of money, or rather as the representative of future money. The seller becomes a creditor, the buyer becomes a debtor. ...[Here] money receives a new function as well. It becomes the means of payment.

The general possibility of crisis is given in the process of metamorphosis of capital itself, and in two ways: in so far as money functions as means of circulation, [the possibility of crisis lies in] the separation of purchase and sale..
and in so far as money functions as means of payment, it has two different aspects, it acts as measure of value and as realization of value. These two aspects [may] become separated. If in the interval between them the value has changed, if the commodity at the moment of sale is not worth what it was worth at the moment when money was acting as a measure of value and therefore as a measure of the reciprocal obligations, then the obligation cannot be met from the proceeds of the sale of the commodity. and therefore the whole series of transactions which retrogressively depend on this one transaction, cannot be settled.

Functions of Money contd.

- Money as store of value

- Money as world money

Capitalist Commodity System

- SCS = ‘stretching’ of commodity principle

- CCS = ‘deepening’ of commodity principle

i.e. commoditisation of labour power capacity

Motivating factor of crisis

Exploitation and profit

Fundamental cause of crisis: profit constraint

Fundamental cause of profit constraint: exploitation

Whatever the source of this tendency in any particular era of growth - be it a declining reserve army, a rising organic composition of capital and/or a problem of underconsumption - the important point is that accumulation, which requires some historically specific minimum rate of profit to sustain itself, eventually causes the rate of profit to decline, thus destroying its most important condition of existence. The tendency for accumulation to eventually lower the profit rate is the crucial link that ties Marx's analysis of capitalist production relations to the previously theorized model of the abstract forms of crisis in commodity exchange (as augmented and transformed by capitalist development), making it possible to construct a unified theory of capitalist crisis.

Crotty (1986)

Interest bearing capital

- Pre-capitalist credit forms: usury; commercial credit
- Capitalist form: banking
- division of profit into industrial profit (profit of enterprise) and bank profit (interest)

Credit "as an essential, developed relation of production appears historically only in circulation based on capital or on wage labour." ... "Credit...is both the result and the condition of capitalist production…"

The "development of the credit-system ...necessarily runs parallel with the development of large-scale industry and capitalist production..."

Large-scale production for distant markets casts the entire product into the arms of commerce; but it is impossible for the nation's capital to double, so that commerce would purchase the entire national product with its own capital before selling it again. Credit is thus indispensable here, a credit that grows in volume with the increasing value of production and grows in duration with the increasing distance of markets. A reciprocal effect takes place here. The development of the production process expands credit, while credit in turn leads to an expansion of industrial and commercial operations.

Interest rate determination

- lower bound =0
- upper bound = average rate of profit
- inverse relation between profit of enterprise and interest

Marx on profit ad interest

- ‘profit of enterprise is not related as an opposite to wage-labour, but only to interest...assuming the average profit to be given, the rate of profit of the profit of enterprise is not determined by wages, but by the rate of interest. It is high or low in inverse proportion to it’

Business cycle and credit

- beginnings of expansion: interest rate low
- mid phase: interest rate average
- boom phase: interest rate high

Speculation

It is the capitalist credit system that is “the principal lever of overproduction and excessive speculation in commerce.... banking and credit become the most powerful means for driving capitalist production beyond its own barriers and one of the most effective vehicles for crisis and swindling.”

Fictitious capital

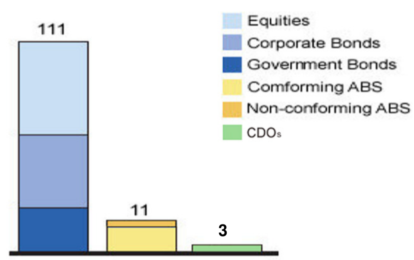
- real capital = self-expanding value where there is human intermediation
- fictitious capital= self-expanding value where there is no human intermediation
- FC such as equities and bonds are claims to future income streams generated by firms
- Price of FC is, in first place, determined by ‘anticipated future incomes to which ownership entitles the holder, capitalized at the going rate of interest”
- But price of FC is also object of speculation

B. The Global Financial Crisis

i. Outline of events and standard explanations.
ii. Marginalisation of Marxist accounts

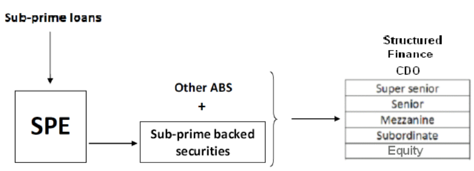
Composition of Securities Stocks, 2006

(US $Trillions)

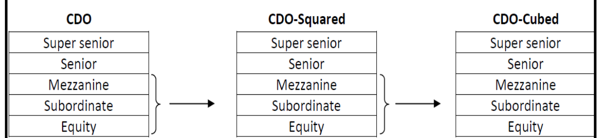


Source: McKinsey (2008); Bank of England (2007)

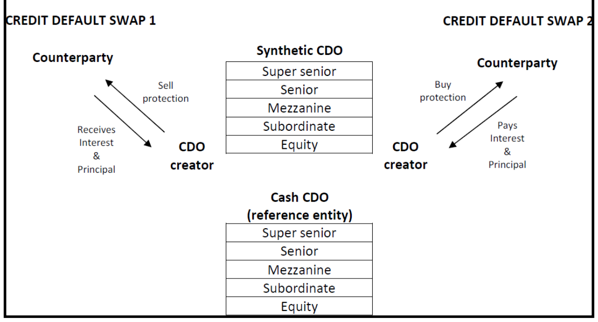
Matryoshka – Russian Doll 1



Matryoshka – Russian Doll 2



Matryoshka – Virtual Russian Doll



1) Exponential growth of sub-prime loans (2001-5)

- Loans securitised through SPEs
- Securities pooled with other asset backed securities (ABS) as collateral for CDOs
- CDOs sold to various investors

2) Rise in interest rate triggers rise in sub-prime default rate (2006)

- Rise in interest rate to control inflationary pressures
- Rise in sub-prime delinquency rate
- Banks hoard cash to protect sponsored vehicles

3) Credit problems in the mortgage markets trigger liquidity problems in the inter-bank money market (2006-7)

- Liquidity dries up in inter-bank market
- Short term rates rise
- Collapse of sub-prime backed asset prices

4) Liquidity – solvency crisis cycle spirals out of control (2007-8)

- Liquidity strains in inter-bank market
- Distress selling of assets
- Threat of insolvency causing further liquidity strains

5) Culminating in collapse of wholesale funding markets causing huge problems for banks (Sept 2008)

- Collapse of Lehman Brothers
- Collapse of wholesale markets for commercial paper
- Catastrophic impact on the large commercial banks

6) Triggers panic selling of bank shares threatening collapse of banking system (Sep-Oct 2008)

- Panic selling of banks' shares
- Government bail out of the banks

Nationalisation of parts of the banking sector

Institutional failures

include

- the overzealous quest for fees and commissions;

- the over-relaxation of lending standards on the part of the mortgage brokers and banks originating the sub-prime loans;

- the highly leveraged and chronically under-capitalised positions of the banks and of their investment vehicles;

- flaws in the risk assessment methods used by the credit rating agencies to rate the various financial products created by the investment banks;

- the lack of proper oversight of the whole shadow banking system on the part of the regulatory authorities.

Crisis transmission mechanisms

GDP Space: Excess Supply of Products

exploitation → realisation constraints → limits to easing of constraints → crisis

Capital Market Space: Excess Demand for Securities

exploitation → realisation constraints → continual easing of constraints through securities → limits to rate of security issuance → crisis

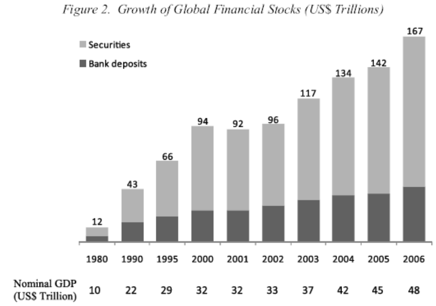
C. An Alternative Marxian explanation of the Subprime Crisis

i: The globalisation of the commodity principle

ii: The globalisation of the exploitation relation

securities		
Equities	Corporate Bonds	Government Bonds
capacities		
Labour Power	Capital	Government
goods		
Goods and Services		

Figure 2. Growth of Global Financial Stocks (US$ Trillions)



Major Holders of Securities, 2010 (US $ tr)

	Total Assets	Securities	Other
Institutional Investors	**77.4**	**63.0**	**14.4**
Pension Funds	31.1	25.2	5.9
Mutual Funds	24.7	21.4	3.3
Insurance Companies	21.6	16.4	5.2
Banks	**100.1**	**49.0**	**51.1**
High Net Worth Individuals	**42.7**	**26.5**	**16.2**
Governments	**11.4**	**9.3**	**2.1**
Reserves	7.2	5.8	1.4
Sovereign Wealth Funds	4.2	3.5	0.7

Organisations as Single Commodity Providers

Investors $\xrightarrow{\text{finance}}$ **Governments** / **Corporations** $\xrightarrow{\text{provide}}$ **Goods & Services**

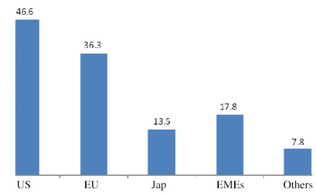
Organisations as Dual Commodity Providers

Governments } provide → Securities purchased for Investment management purposes

Corporations } provide → Goods & Services purchased for Consumption & Production purposes

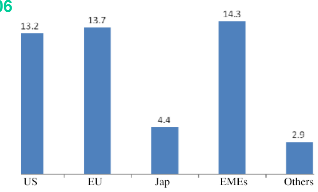
World Capital Markets: 2006

(US $Trillions)

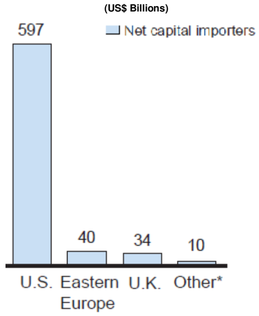


World GDP: 2006

(US $Trillions)



US Net Inflows (Av. 2001-2006)



*Includes Australia, New Zealand and Canada

Source: McKinsey (2008)

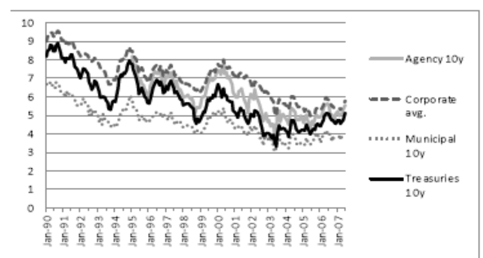
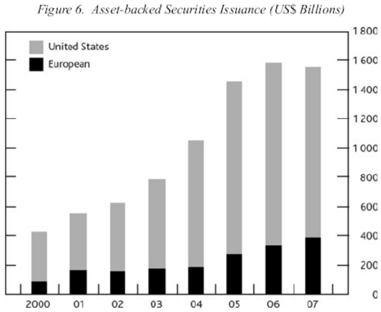
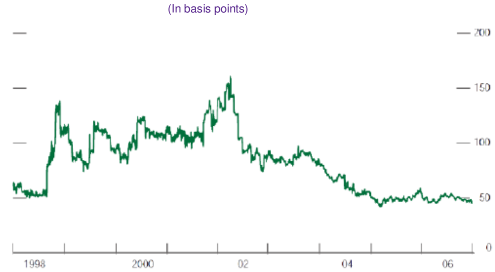


Figure 6. Asset-backed Securities Issuance (US$ Billions)



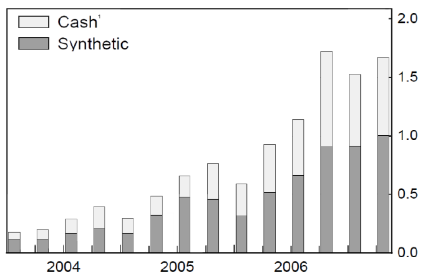
United States: ABS Spread

(In basis points)



Source: IMF (2008)

Growth of CDOs
($trillions)



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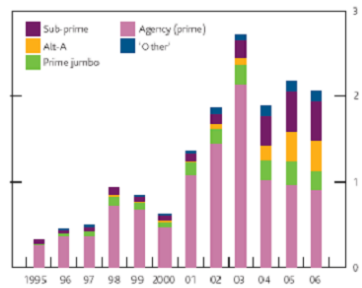
US Residential Mortgage-Backed Securities Issuance

(US $Trillions)



Source: Bank of England (2008)

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"To a significant degree it has been the reach for yield on the part of institutional investors in particular that goes a considerable distance in explaining this very rapid growth of structured credit products"

(Gerald Corrigan, Statement to HoC, Treasury Committee, 28th Feb, 2008.)

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Mike Francis, executive director at Morgan Stanley on the residential mortgage trading desk, stated in an interview: "We almost couldn't produce enough to keep the appetite of our investors happy. More people wanted bonds than we could actually produce. That was our difficult task, was trying to produce enough. They would call and say, we're looking for more fixed rate. What have you got? Do you have anything coming? What's going on? Tell us what you're trying to do. From our standpoint it's like, there's a guy out there with a lot of money. And we have got to find a way to become his sole provider of bonds, of mortgage bonds, to fill his appetite. And his appetite's massive." (This American Life, 2008).

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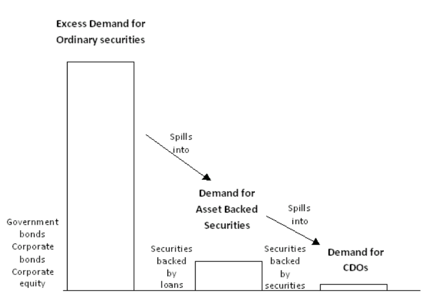

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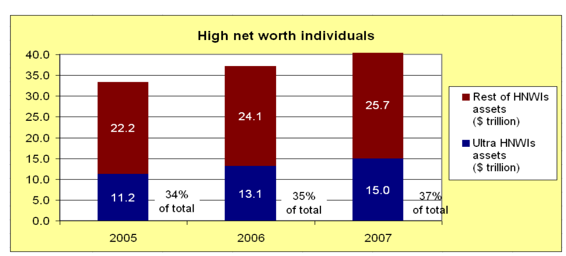

Source: IFSL International Private Wealth Management 2009

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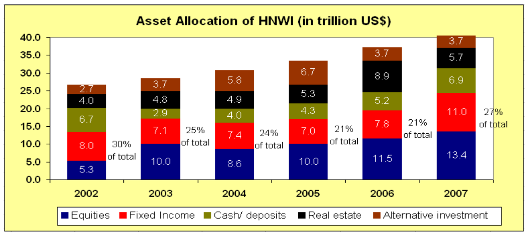
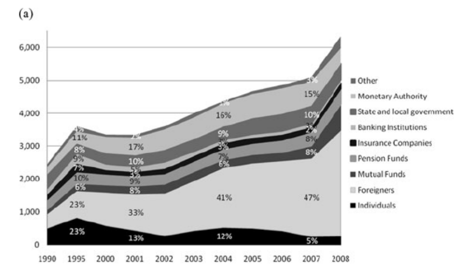
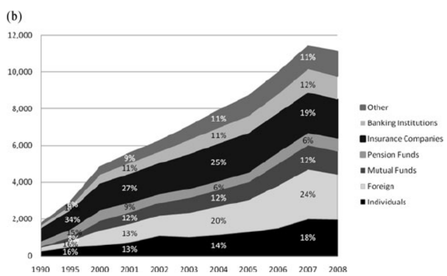
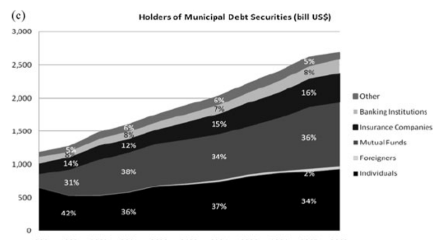


Source: Capgemini Merrill Lynch Wealth Reports 2005, 2006 and 2009 (and own calculation)

Figure 4. (a) Holders of US Treasury Securities. (b) Holders of Corporate and Foreign Bonds. (c) Holders of Municipal Debt Securities







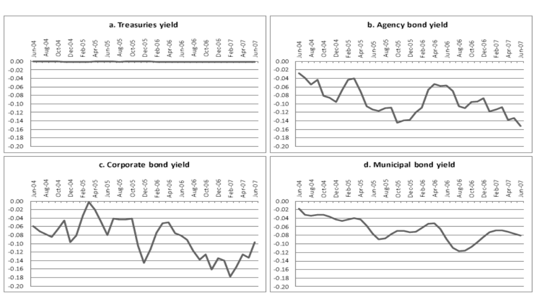
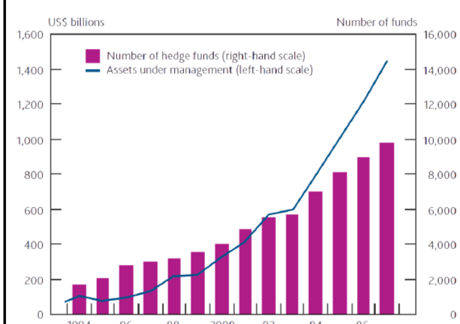


Figure 8. Estimated impact of HNWIs demand on AAA-rated long-term yields (in % points)

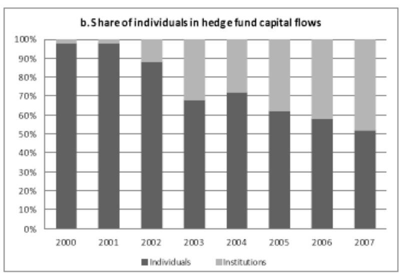
Number of hedge funds and assets under management



Source: Bank of England, 2007.

Table 7. *Holdings of CDO buyers by June 2007*

CDO Tranche	Hedge Funds	Banks	Asset Managers	Insurance Companies
AAA	12%	15%	6%	7%
AA	4%	4%	4%	1%
A	5%	1%	3%	0%
BBB	4%	0%	4%	1%
BB	2%	0%	0%	0%
Equity	19%	5%	2%	1%
Total %	47%	25%	19%	10%
Total US$ bn	1,396	746	564	295



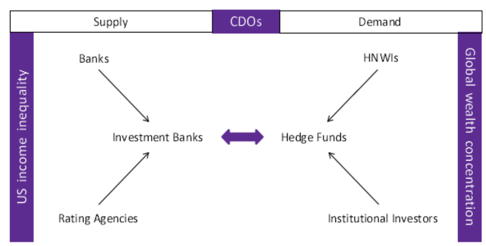


Figure 10. *Outline of the main forces in the CDO market*

Crisis transmission mechanisms

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Capital Market Space: Excess Demand for Securities

exploitation → realisation constraints → continual easing of constraints through securities → limits to rate of security issuance → crisis

Further Reading

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