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Classical economists developed the labor theory of value to isolate economic rent, which they defined as the excess of market price and income over the socially necessary cost of production (value ultimately reducible to the cost of labor). A free market was one free of such "unearned" income – a market in which prices reflected actual necessary costs of production or, in the case of public services and basic infrastructure, would be subsidized in order to make economies more competitive. Most reformers accordingly urged – and expected – land, monopolies and banking privileges to be nationalized, or at least to have their free-lunch income taxed away.

In keeping with his materialist view of history, Marx expected banking to be subordinated to the needs of industrial capitalism. Equity investment – followed by public ownership of the means of production under socialism – seemed likely to replace the interest-extracting "usury capital" inherited from antiquity and feudal times: debts mounting up at compound interest in excess of the means to pay, culminating in crises marked by bank runs and property foreclosures.

But as matters have turned out, the rentier interests mounted a Counter-Enlightenment to undermine the reforms that promised to liberate society from special privilege.

Instead of promoting capital investment in an alliance with industry and government, financial planners have sponsored a travesty of free markets. Realizing that income not taxed is free to be capitalized, bought and sold on credit, and paid out as interest, bankers have formed an alliance between finance, insurance and real estate (FIRE) to free land rent and monopoly rent (as well as debt-leveraged "capital" gains) from taxation.

The result is that today's economy is burdened with property and financial claims that Marx and *other critics deemed "fictitious" – a proliferation of financial overhead in the form of interest and dividends, fees and commissions, exorbitant management salaries, bonuses and stock options, and "capital" gains (mainly debt-leveraged land-price gains). And to cap matters, new financial modes of exploiting labor have been innovated, headed by pension-fund capitalism and privatization of Social Security. As economic planning has passed from government to the financial sector, the alternative to public price regulation and progressive taxation is debt peonage.*

In his draft notes on "Interest-Bearing Capital and Commercial Capital in Relation to Industrial Capital" for what became Vol. III of Capital and Part III of Theories of Surplus Value, Marx wrote optimistically about how industrial capitalism would modernize banking and financial systems. Its historical task, he believed, was to rescue society from usurious money lending and asset stripping, replacing the age-old parasitic tendencies of banking by steering credit to finance productive investment.

The commercial and interest-bearing forms of capital are older than industrial capital, but … [i]n the course of its evolution, industrial capital must therefore subjugate these forms and transform them into derived or special functions of itself. It encounters these older forms in the epoch of its formation and development. It encounters them as antecedents … not as forms of its own life-process. … Where capitalist production has developed all its manifold forms and has become the dominant mode of production, interest-bearing capital is dominated by industrial capital, and commercial capital becomes merely a form of industrial capital, derived from the circulation process. [2]

From antiquity through medieval times, investment was self-financed – and hence was undertaken mainly by large public institutions (temples and palaces) and by the well to do. It was the great achievement of industrial capitalism to mobilize credit to finance production, subordinating hitherto usurious interest-bearing capital to "the conditions and requirements of the capitalist mode of production." [3] "What distinguishes the interest-bearing capital, so far as it is an essential element of the capitalist mode of production, from usurer's capital," Marx wrote, is "the altered conditions under which it operates, and consequently the totally changed character of the borrower …" [4]

Marx expected the Industrial Revolution's upsweep to be strong enough to replace this system with one of productive credit, yet he certainly had no blind spot for financial parasitism. [5] Money-lending long preceded industrial capital and was external to it, he explained, existing in a symbiosis much like that between a parasite and its host. "Both usury and commerce exploit the various modes of production," he wrote. "They do not create it, but attack it from the outside." [6]

In contrast to industrial capital (tangible means of production), bank loans, stocks and bonds are legal claims on wealth. These financial claims do not create the surplus directly, but are like sponges absorbing the income and property of debtors – and expropriate this property when debtors (including governments) cannot pay. "Usury centralises money wealth," Marx elaborated. "It does not alter the mode of production, but attaches itself to it as a parasite and makes it miserable. It sucks its blood, kills its nerve, and compels reproduction to proceed under even more disheartening conditions. … usurer's capital does not confront the laborer as industrial capital," but "impoverishes this mode of production, paralyzes the productive forces instead of developing them." [7]

Engels noted that Marx would have emphasized how finance remained largely predatory had he lived to see France's Second Empire and its "world-redeeming credit-phantasies" explode in "a swindle of a magnitude never witnessed before." [8] But more than any other writer of his century, Marx described how periodic financial crises were caused by the tendency of debts to grow exponentially, without regard for growth in productive powers. His notes provide a compendium of writers who explained how impossible it was in practice to realize the purely mathematical "magic of compound interest"– interest-bearing debts in the form of bonds, mortgages and commercial paper growing independently of the economy's ability to pay. [9]

This self-expanding growth of financial claims, Marx wrote, consists of "imaginary" and "fictitious" capital inasmuch as it cannot be realized over time. When fictitious financial gains are obliged to confront the impossibility of paying off the exponential growth in debt claims – that is, when scheduled debt service exceeds the ability to pay – breaks in the chain of payments cause crises. "The greater portion of the banking capital is, therefore, purely fictitious and consists of certificates of indebtedness (bills of exchange), government securities (which represent spent capital), and stocks (claims on future yields of production)." [10]

A point arrives at which bankers and investors recognize that no society's productive powers can long support the growth of interest-bearing debt at compound rates. Seeing that the pretense must end, they call in their loans and foreclose on the property of debtors, forcing the sale of property under crisis conditions as the financial system collapses in a convulsion of bankruptcy.

To illustrate the inexorable force of usury capital unchecked, Marx poked fun at Richard Price's calculations about the magical power of compound interest, noting that a penny saved at the birth of Jesus at 5% would have amounted by Price's day to a solid sphere of gold extending from the sun out to the planet Jupiter. [11] "The good Price was simply dazzled by the enormous quantities resulting from geometrical progression of numbers. … he regards capital as a self-acting thing, without any regard to the conditions of reproduction of labour, as a mere self-increasing number," subject to the growth formula Surplus = Capital (1 + interest rate)n, with n representing the number of years money is left to accrue interest.

The exponential all-devouring usury "assimilates all the surplus value with the exception of the share claimed by the state." [12] That at least was the hope of the financial class: to capitalize the entire surplus into debt service. "Under the form of interest the whole of the surplus over the necessary means of subsistence (the amount of what becomes wages later on) of the producers may here be devoured by usury (this assumes later the form of profit and ground rent)."

Although high finance obviously has been shaped by the Industrial Revolution's legacy of corporate finance, institutional investment such as pension fund saving as part of the industrial wage contract, mutual funds, and globalization along "financialized" lines, financial managers have taken over industrial companies to create what Hyman Minsky has called "money manager capitalism." [13]

The last few decades have seen the banking and financial sector evolve beyond what Marx or any other 19th-century writer imagined. Corporate raiding, financial fraud, credit default swaps and other derivatives have led to de-industrialization and enormous taxpayer bailouts. And in the political sphere, finance has become the great defender of deregulating monopolies and "freeing" land rent and asset-price gains from taxation, translating its economic power and campaign contributions into the political power to capture control of public financial regulation. The question that needs to be raised today is therefore which dynamic will emerge dominant: that of industrial capital as Marx expected, or finance capital?

Marx's optimism that industrial capital would subordinate finance capital to its own needs

Despite Marx's explanation of how parasitic finance capital was in its manifestation as "usury capital," he believed that its role as economic organizer would pave the way for a socialist organization of the economic surplus. Industrial capital would subordinate finance capital to serve its needs. No observer of his day was so pessimistic as to expect finance capitalism to overpower and dismantle industrial capitalism, engulfing economies in parasitic credit such as the world is seeing today. Believing that every mode of production was shaped by the technological, political and social needs of economies to advance, Marx expected banking and high finance to become subordinate to these dynamics, with governments accommodating forward planning and long-term investment, not asset-stripping.

"There is no doubt," he wrote, "that the credit system will serve as a powerful lever during the transition from the capitalist mode of production to the production by means of associated labor; but only as one element in connection with other great organic revolutions of the mode of production itself." [14] Governments for their part would become socialist, not be taken over by the financial sector's lobbyists and proxies.

Discussing the 1857 financial crisis, Marx showed how unthinkable anything like the 2008-09 Bush-Obama bailout of financial speculators appeared in his day. "The entire artificial system of forced expansion of the reproduction process cannot, of course, be remedied by having some bank, like the Bank of England, give to all the swindlers the deficient capital by means of its paper and having it buy up all the depreciated commodities at their old nominal values." [15] Marx wrote this reductio ad absurdum not dreaming that it would come true in autumn 2008 as the U.S. Treasury paid off all of A.I.G.'s gambles and other counterparty "casino capitalist" losses at taxpayer expense, followed by the Federal Reserve buying junk mortgage packages at par.

Marx expected economies to act in their long-term interest to increase the means of production and avoid over-exploitation, under-consumption and debt deflation. Yet throughout his notes for what became Capital and Theories of Surplus Value, he described how finance capital took on a life of its own. Industrial capital makes profits by spending money to employ labor to produce commodities to sell at a markup, a process he summarized by the formula M-C-M'. Money (M) is invested to produce commodities (C) that sell for yet more money (M'). But usury capital seeks to make money in "sterile" ways, characterized by the disembodied (M-M').

Growing independently from tangible production, financial claims for payment represent a financial overhead that eats into industrial profit and cash flow. Today's financial engineering aims not at industrial engineering to increase output or cut the costs of production, but at the disembodied M-M' – making money from money itself in a sterile "zero-sum" transfer payment.

As matters have turned out, the expansion of finance capital has taken the form mainly of what Marx called "usury capital": mortgage lending, personal and credit card loans, government bond financing for war deficits, and debt-leveraged gambling. The development of such credit has added new terms to modern language: "financialization," debt leveraging (or "gearing" as they say in Britain), corporate raiding, "shareholder activists," junk bonds, government bailouts and "socialization of risk," – as well as the "junk economics" that rationalizes debt-leveraged asset-price inflation as "wealth creation" Alan Greenspan-style.

Fictitious Capital

Bankers and other creditors produce interest-bearing debt. That is their commodity as it "appear[s] in the eyes of the banker," Marx wrote. Little labor is involved. Calling money lent out at interest an "imaginary" or "void form of capital," [16] Marx characterized high finance as based on "fictitious" claims for payment in the first place because it consists not of the means of production, but of bonds, mortgages, bank loans and other claims on the means of production. Instead of consisting of the tangible means of production on the asset side of the balance sheet, financial securities and bank loans are claims on output, appearing on the liabilities side. So instead of creating value, bank credit absorbs value produced outside of the rentier FIRE sector.

"The capital of the national debt appears as a minus, and interest-bearing capital generally is the mother of all crazy forms …" [17] What is "insane," he explained, is that "instead of explaining the self-expansion of capital out of labor-power, the matter is reversed and the productivity of labor-power itself is this mystic thing, interest-bearing capital." [18]

Financialized wealth represents the capitalization of income flows. If a borrower earns 50 pounds sterling a year, and the interest rate is 5%, this earning power is deemed to be "worth" Y/I, that is, income (Y) discounted at the going rate of interest (i): 1,000 pounds. A lower interest rate will increase the capitalization rate – the amount of debt that a given flow of income can carry. "The forming of a fictitious capital is called capitalising. Every periodically repeated income is capitalised by calculating it on the average rate of interest, as an income which would be realised by a capital at this rate of interest." Thus, Marx concluded: "If the rate of interest falls from 5% to 2½%, then the same security will represent a capital of 2000 pounds sterling. Its value is always but its capitalised income, that is, its income calculated on a fictitious capital of so many pounds sterling at the prevailing rate of interest."

Finance capital is fictitious in the second place because its demands for payment cannot be met as economy-wide savings and debts mount up exponentially. The "magic of compound interest" diverts income away from being spent on goods or services, capital equipment or taxes. "In all countries of capitalist production," Marx wrote, the "accumulation of money-capital signifies to a large extent nothing else but an accumulation of such claims on production, an accumulation of the market-price, the illusory capital-value, of these claims." Banks and investors hold these "certificates of indebtedness (bills of exchange), government securities (which represent spent capital), and stocks (claims on future yields of production)" whose face value is "purely fictitious." [19] This means that the interest payments that savers hope to receive cannot be paid in practice, because they are based on fiction – junk economics and junk accounting, which are the logical complements to fictitious capital.

Finance capital sees any flow of revenue as economic prey – industrial profit, tax revenue, and disposable personal income over and above basic needs. The result is not unlike the "primitive accumulation" by armed conquest – land rent paid initially to warrior aristocracies. And much as the tribute taken by the military victors is limited only by the defeated population's ability to produce an economic surplus, so the accrual of interest on savings and bank loans is constrained only by the ability of borrowers to pay the mounting interest charges on these debts.

The problem is that the financial system, like military victors from Assyria and Rome in antiquity down to those of today, destroys the host economy's ability to pay.

The falling rate of profit (rising depreciation element of ebitda) as distinct from financial crises

Focusing on profit as reflecting the industrial exploitation of wage labor, many students of Marxism have read only Vol. I of Capital. Many make an unwarranted leap from his analysis of wage labor to assume that he was an underconsumptionist. The capitalist's desire to pay employees as little as possible (so as to maximize the margin they would make by selling their products at a higher price) is taken as a proxy for the financial dynamics causing crises, discussed in Vol. III of Capital.

Marx's analysis did note the problem of labor's inability to buy what it produces. "Contradiction in the capitalist mode of production," he wrote: "the labourers as buyers of commodities are important for the market. But as sellers of their own commodity – labour-power – capitalist society tends to keep them down to the minimum price." [20]

To avoid a glut on the market, workers must buy what they produce (along with industrialists buying machinery and other inputs). Henry Ford quipped that he paid his workers the then-high wage of $5 per day so that they would have enough to buy the cars they produced. But most employers oppose higher wages, paying as little as possible and thus drying up the market for their products.

This was the major form of class warfare in Marx's day, but it was not the cause of financial crises, which Marx saw as being caused by internal contradictions on the part of finance capital itself. Interest charges on rising debt levels absorb business and personal income, leaving less available to spend on goods and services. Economies shrink and profits fall, deterring new investment in plant and equipment. Financial "paper wealth" thus becomes increasingly antithetical to industrial capital, to the extent that it takes the predatory form of usury-capital – or its kindred outgrowth, financial speculation – rather than funding tangible capital formation.

In developing his model to analyze the flows of income and output among labor, capital and the rest of the economy, Marx's starting point was the first great example of national income accounting: Francois Quesnay's Tableau Économique (1758) describing the circulation of payments and output in France's agricultural sector, labor, industry and the government. As a surgeon to the king, Quesnay saw this circulation of income as analogous to that of blood within the human body. However, his Tableau neglected the need to replenish stock – the seed and other output that needed to be set aside to plant the next season's crop. Marx noted that much as rural cultivators needed to defray the cost of replenishing their seed-corn, industrialists needed to recover the cost of their capital investment in plant, equipment and kindred outlays, in addition to receiving profits.

This recovery of capital outlays is called depreciation and amortization. Marx expected it to rise relative to profits, in order to reimburse investment in capital equipment (and by logical extension, research and development). This is what he meant by the falling rate of profit. Just as bondholders recover their original capital principal (a return of financial capital) quite apart from the interest, so capitalists must recover the cost of their original investment.

Marx expected technology to become more capital-intensive in order to be more productive.

His “falling rate of profit” referred to the rising depreciation return of capital to reflect this recovery of costs. Plant and equipment needed to be renewed as a result of wearing out or becoming technologically obsolete and hence needing to be scrapped even when it remains physically operative. As Joseph Schumpeter emphasized in his post-Marxist theory of innovation, technological progress obliges industrialists either to modernize or be undersold by rivals.

This rising capital-intensiveness is not a cause of crises. As Marx argued in Book II of Theories of Surplus Value against Ricardo’s views on the introduction of machinery, it creates a demand for more capital spending and hence employs more labor, averting an underconsumption crisis. However, financial crises still occur (Marx pointed to eleven-year intervals in his day) as a result of the interest-bearing savings of the wealthy lent out to government, business and (mainly since Marx’s day) real estate and individuals, erupting when debtors are unable to pay this self-expanding financial overhead of “anti-wealth.”

No concept has confused students of Marxism more than this seemingly straightforward idea. [21]
At issue is the shifting composition of cash flow: earnings before interest, depreciation and amortization (ebitda). To the extent that depreciation and amortization rise (or as industry becomes more highly debt leveraged), less profit is reported to the tax authorities and recorded in the National Income and Product Accounts. Marxists who attribute a crisis of capitalism to declines in reported rates of profit overlook the fact that the real estate, mining and insurance sectors wring their hands all the way to the bank with tax-deductible cash flow counted as “depreciation.”

How real estate, mining and debt-leveraged business exemplify a pseudo-falling rate of profit

The largest sector in today’s economies remains real estate. Land is the single largest asset, and buildings report most depreciation. To be sure, this is a travesty of economic reality inasmuch as it reflects a distorted set of tax laws that permit absentee investors to depreciate buildings again and again, as if they wear out and lose value through lack of upkeep (despite landlords being legally required to maintain rental properties intact), or by obsolescence (even as construction standards cheapen). These depreciation writeoffs occur at rising prices each time a property is sold at a capital gain (most of which reflects the land’s rising site value).

This pretense – along with the tax deductibility of interest – has enabled real estate investors to declare virtually no taxable income for more than a half century since World War II. It is as if a bond- or stock-holder could avoid paying income tax on interest and dividends by getting a tax credit as if the bond or stock were becoming worthless – and for each new buyer to repeat this charge-off, as if the asset loses value with each sale even as its market price rises! To cap matters, "capital gains" (some 80 percent of which typically occur in the real estate sector) are taxed at only a fraction of the rate levied on "earned" income (wages and profits), and are not taxed if they are spent on buying yet more property.

These tax dodges benefit property owners – and behind them, bankers, because whatever the tax collector refrains from taking is "free" to be paid as interest for yet larger mortgage loans. This makes financial interests the ultimate beneficiaries of distorted tax accounting. Such tax favoritism for the FIRE sector is fictitious tax avoidance, capitalized into "capital" gains. This obviously is not what Marx meant by the falling rate of profit. In his day there was no income tax to inspire such "junk accounting."

The aim of permitting buildings to be depreciated again and again is not to reflect economic reality but to save real estate investors from having to declare taxable earnings ("profit"). And thanks to the notorious depletion allowance, the oil and mining sectors likewise operated free of income taxation for many decades. Insurance and financial companies are permitted to treat the buildup of liquid reserves as an "expense" against hypothetical losses. The function of these giveaways is to shift the fiscal burden off land and minerals, oil and gas, real estate and debt-leveraged industry.

When an ostensibly empirical statistical map (or the economic theory behind it) diverges from reality, and a tax policy diverges from broad social objectives, one invariably finds a special interest at work subsidizing it. In this case the culprit is high finance as untaxed property revenue is free to be capitalized into larger debts. And as it has regressed to what Marx described as usury capital, it has allied itself with real estate and rent-extracting monopolies. Instead of nationalizing them or taxing their economic rent and "capital" gains, today's tax system favors rentiers.

The financial and industrial antipathy to post-feudal rent-seekers

The financial sector's alliance with manufacturing rather than real estate in David Ricardo's day is rooted in medieval European banking as it emerged at the time of the Crusades. Christian sanctions against usury were broken down by a combination of the prestige of the major creditors – Church orders, followed by bankers tied to the papacy – and that of their leading borrowers: kings, to pay Peter's Pence and other tribute to Rome, and increasingly to wage war.

As creditors, the Templars and Hospitallers pioneered the transfer of funds across Europe. Next to royal borrowing the major market for credit was foreign trade, which flowered with the revival of economic activity fueled largely by the gold and silver looted from Byzantium in 1204. This business prompted the Churchmen to define a fair price for bankers to charge for the international transfer of funds – agio. This became the major "loophole" in which money lending could occur, most notoriously in a fictitious "international" arrangement via the "dry exchange." These financial practices – war lending to kings for spending abroad, and money changing as commercial activity revived – made banking cosmopolitan in outlook.

The Napoleonic Wars (1798-1815) impeded trade, and hence its import and export financing. France's naval blockade had the effect of a protective tariff wall. Britain's landlords increased crop production, albeit at a rising cost. Conversely, other countries built up their own manufacturing. Resumption of foreign trade after the Treaty of Ghent restored peace in 1815 caused economic crises for these newly vested interests. Imports threatened to undercut the prices that British landlords received, reducing their land rents, prompting them to press for agricultural tariffs – the Corn Laws. Meanwhile, British manufactures undersold foreign production, prompting American and French industrialists to press for tariff protection. Britain, the United States, France and Germany thus experienced a fight between free traders and protectionists.

Having grown wealthy during Britain's rise as a manufacturing power, its bankers looked forward to a resumption of trade financing, with Britain serving as "workshop of the world" – and banker to it. David Ricardo, the leading advocate for Britain's bankers, lobbied for free trade and an international specialization of production, not national self-reliance. The resulting tariff fight culminated in 1846 with repeal of the Corn Laws. Unless Britain imported low-priced crops, Ricardo argued, rising domestic food prices as a result of diminishing returns on Britain's limited soil area would prevent British industry from exporting competitively – and hence, would not be able to expand trade financing from British banks. [22]

Debt appeared nowhere in Ricardo's labor theory of value. He was silent when it came to the original analysis of cost value – the medieval Churchmen's concept of Just Price with regard to agio charges. Adam Smith, Malachy Postlethwayt and other writers had focused on the extent to which the taxes levied to pay interest on the national debt increased the cost of living. James

Steuart had pointed to the exchange rate problems caused by sending money abroad for debt service (mainly to the Dutch) or military spending and subsidies. Ricardo would have none of this. He insisted before Parliament that banking never could cause an economic problem! “Capital transfers” from military spending, debt service and international investment would be automatically self-financing.

This was the genesis of today’s “free market” deregulatory theory. Ignoring the debt dimension, Ricardo became the doctrinal ancestor of Milton Friedman’s Chicago School of monetarists. The difference is that whereas they insist that there is no such thing as a free lunch, he defined economic rent as unearned income. “Ricardian socialists” extended the concept of economic rent to a full-fledged attack on landlordism. The Ricardian journalist James Mill advocated Britain’s “original” Domesday Book principle that groundrent should be the tax base. His son, John Stuart Mill, became a leading advocate of nationalizing the economic rent that landlords made “in their sleep” and the “unearned increment” of rising land prices.

The drive to break the power of landed aristocracies in Britain, France and other countries became the major political fight from the century spanning 1815 and World War I. It was basically a class struggle between capital and landowners. The demand “that rent should be handed over to the state to serve in place of taxes,” Marx explained, “is a frank expression of the hatred the industrial capitalist bears towards the landed proprietor, who seems to him a useless thing, an excrescence upon the general body of bourgeois production.” [23] By taxing the land’s rental income and that of subsoil minerals provided freely by nature, industry could free itself from the sales and excise taxes that raised the cost of living and doing business.

Since the 13th century the labor theory of value had been refined as a tool to isolate the elements of “empty” pricing that had no counterpart cost of production. Rent and interest were a vestiges of medieval privilege from which industrial capitalism sought to purify itself. Its idea of free markets was to liberate society from the overhead of groundrent, monopoly rent and interest, bringing land and finance into the public domain – “socialize” them by transforming banking and finance capital to serve the needs of industrial capitalism.

Marx expected industrial capitalism to pave the way for socialism by freeing Europe (and in time, its colonies and the continents of Asia, Africa and Latin America) from the carry-over of land rent imposed originally by military force, and from financial usury capital. The tacit assumption was that industrial financial systems would play as progressive a role in these regions as they were expected to do in the core. The Communist Manifesto credited the bourgeois economics of land taxers and kindred reformers in France and Britain with seeking to move society beyond the feudal mode of production.

However, it criticized Europe's revolutions of 1848 for stopping short of helping labor. The fight to tax the land's rent – as the Physiocrats had sought to do with their Single Tax (L'Impôt Unique) and as Mill, Cherbuliez, Hilditch, Proudhon and other reformers advocated – was basically a fight by industry (and its financial backers) to minimize the cost of feeding labor, not to raise wages and living standards or improve working conditions. Most reformers left private property in place, limiting their aims to freeing markets from the rake-off of economic rent by landlords and monopoly privileges, and only secondarily from the interest charged by bankers and usurers.

Marxists accordingly criticized "utopian" socialists and anti-socialist individualists such as Henry George for dealing only with the land issue or naïve monetary reforms without addressing labor's fight to improve its working conditions and ultimately to free itself from private property in the means of production. Arguing against followers of George, Louis Untermann noted that in Germany, Ferdinand Lassalle found in Ricardian economics an implicitly socialist program, but "never indulged in any illusions as to the efficacy of that Single Tax idea for the emancipation of the working class." [24] This required a government that would play an active role promoting labor's interests vis-à-vis industrial capital, not only through regulatory reforms but by outright state ownership of the means of production under working-class control.

The argument over how productive an industrial role high financial would play

The 1815-1914 century was relatively free of war. America's Civil War was the most devastating. But instead of borrowing from bankers, the North issued its own greenback currency. This success prompted bankers throughout the world to redouble their propaganda for "hard money," as if bank credit was inherently sounder than public money creation. Subsequent development does not support this claim.

The Franco-Prussian War saddled France with a reparations debt that it was able to finance without causing any great disturbance. Economists attributed the decline of interest rates over time to the world becoming more secure. Public spending was increasingly for infrastructure to support industrial progress. There was heavy arms spending, to be sure, especially on navies, but it aimed largely to build up industry in a three-way alliance between industry, government and high finance. Governments and the large banks were emerging as national planners via their allocation of credit and public spending.

The most productive industrial financing practice emerging on the European continent, especially in Germany where banking developed the closest linkages with the government and heavy industry. The relative absence of large fortunes made a virtue of necessity. Germany's lag in industrial development obliged its banks and government agencies to take a long-term view based on building up strength over time.

Rather than following British and Dutch banks by making straight interest-bearing loans against collateral already in place, the Reichsbank and other large banks engaged in a broad range of activities ("mixed banking"), including equity cross-holdings with their major customers. (After World War II, Japan's cash-starved economy and widespread destruction likewise led its banks to establish close debt-equity relationships with their customers in order to provide sufficient liquidity to build for the future.)

Germany's rapid victories over France and Belgium after war broke out in 1914 were widely viewed as reflecting the superior efficiency of its banking system. To some observers the Great War appeared as a struggle between rival forms of financial organization, to decide not only who would rule Europe but also whether the continent would have laissez faire or a more state-socialist economy. I

n 1915, shortly after fighting broke out, the German Christian Socialist priest-politician Friedrich Naumann summarized the continental banking philosophy in Mitteleuropa. In England, Herbert Foxwell drew on Naumann's arguments in two essays published in the Economic Journal in September and December 1917, [25] quoting with approval Naumann's contention that "the old individualistic capitalism, of what he calls the English type, is giving way to the new, more impersonal, group form; to the discipline, scientific capitalism he claims as German."

In the emerging tripartite integration of industry, banking and government, finance was "undoubtedly the main cause of the success of modern German enterprise."

What is striking is how unlikely the prospect of corrosive and unproductive debt appeared a century ago. To be sure, Turkey and Egypt were ruined by foreign debt, and massive fraud and insider dealing occurred in ambitious projects such as the Panama and Suez Canals. But the logic of far-reaching financial reform was formulated with evangelical fervor, most notably in France. Count Claude-Henri de Saint-Simon's Du Système Industriel (1821) inspired an ideology based on the perception that successful industrialization would require a shift away from interest-bearing debt to equity funding. Banks would be organized much like mutual funds.

Glorifying bankers as the future organizers of industry, the Saint-Simonians saw the Industrial Revolution as introducing the capitalist travailleur, a financial engineer judging where credit could best be applied. [26] Prominent Saint-Simonians included the social theorist Auguste Comte, the economist Michel Chevalier, the socialist Pierre Leroux, and the engineer Ferdinand Lesseps whose plans for canals elaborated ideas initiated by Saint-Simon. Outside of France their influence extended to Marx, John Stuart Mill and Christian Socialists in many countries. “Marx spoke only with admiration of the genius and encyclopedic brain of Saint-Simon,” noted Engels. [27]

In 1852, Emile Pereire and his younger brother Isaac formed the Société Génerale du Crédit Mobilier as a joint-stock bank. Their aim was to provide low-cost long-term equity financing for industrialists to expand production, replacing the Rothschilds and other banking families who had monopolized French finance by. However, as government insiders got into the game they corrupted the institution. The Austrian Credit Anstalt für Handel und Gewerbe became a more successful application of Credit Mobilier principles.

Banking in the English-speaking countries remained more in the character of what Marx described as usury capital. British and Dutch practice had long used debt leverage to establish royal monopolies, e.g., as when the Bank of England’s monopoly of money issue was obtained in exchange for payment in government bonds. (U.S. bankers do much the same to today’s debtor countries, threatening them with financial crisis if they do not relinquish financial control of the public domain to global banks.)

Based on capitalizing existing income streams as collateral, Anglo-Dutch banking seemed obliged either to modernize along more industrial lines or make its economies financially obsolete. Foxwell warned that British steel, automotives, capital equipment and other heavy industry was in danger of becoming obsolescent largely because the nation’s bankers failed to understand the need to extend longterm credit and promote equity investment to expand industrial production.

The problem had its roots in the conditions in which British banking took shape. At the time Adam Smith wrote The Wealth of Nations, neither his Scottish contemporary James Watt nor other inventors were able to obtain bank loans to introduce their discoveries. They had to rely on their own families and friends, as industrial credit had not yet developed. Banks issued bills of exchange to finance the shipment of goods once these were produced, but not their manufacture. Procedures were in place to discount bills for immediate payment, and to evaluate the borrowing capacity of enterprises whose assets could be quickly liquidated, or well attested income streams that could be capitalized to carry bank loans, as in the case with real property. The preferred collateral was real estate, along with railroads and public utilities with a stable income stream.

The Duke of Bridgewater ran up immense personal debts to finance his canals by 1762, to be sure, but these were secured by mortgages against his property. But early innovations such as the automobile had to wait over half a century to obtain financing. “The investment banking houses had little to do with the financing of corporations or with industrial undertakings. The great investment houses bitterly opposed the numerous corporate issues which were floated in 1824 and 1825,” summarizes one financial historian. “The investment houses for a long time refused to take part even in the financing of the British railways.” [28]

British bankers were prone to insist that companies they controlled pay out most of their earnings as dividends and remain highly liquid rather than providing enough financial leeway for them to pursue a long-term investment strategy. By contrast, the major German banks paid out dividends at only half the rate of British banks, retaining their earnings as a capital reserve invested largely in the stock of their industrial clients. Treating their borrowers as allies rather than merely trying to make a profit as quickly as possible, they expected their customers to invest their profits in expanding production rather than paying them out as dividends.

Britain’s bond and stockbrokers were no more up to the task of financing industrial innovation than were its banks. The fact that manufacturing companies could obtain significant funding only after they had grown fairly large prompted broad criticism of Britain’s joint-stock banks by the 1920s for their failure to finance industry and their favoritism toward international rather than domestic clients. [29]

Much as American “activist shareholders” do today after earning their commissions on an issue, they moved on to the next project without much concern for what happened to the investors who had bought the earlier securities. “As soon as he has contrived to get his issue quoted at a premium and his underwriters have unloaded at a profit,” complained Foxwell in 1917 (loc. cit.), “his enterprise ceases. ‘To him,’ as the Times says, ‘a successful flotation is of more importance than a sound venture.’”

Defeat of Germany and the Central Powers in 1917 paved the way for Anglo-Dutch banking principles to become ascendant. Wall Street from the outset had followed the practice of hit-and-run stock manipulations and short-term financial extraction of the sort that Marx and other Progressive Era writers believed was becoming a thing of the past. U.S. railroad barons and financial manipulators were notorious for issuing "watered stock" to themselves, "overfunding" companies with bond borrowings beyond their needs or capacity to carry. The directors of these corporations pocketed the difference – a practice that led much American industry to stay clear of banking and Wall Street out of self-protection.

Neither economists nor futurists anticipated that economic practices might regress. The working assumption is that a positive evolution would occur to more productive forms. But the banking practices of finance capitalism have regressed toward short-term predatory lending. Reversing an eight-century trend, financial laws have become more creditor-oriented. The tax system also has become regressive, reversing the Progressive Era's financial-fiscal program by un-taxing property and wealth, shifting the fiscal burden onto labor and industry.

The symbiosis of finance capital with real estate and monopolies rather than industry

Marx expected industrial capital to use its rising power over governments to nationalize land and use its rent as the basic fiscal revenue. But it has been the banks that have obtained the lion's share of land rent, capitalizing it into interest-bearing loans to new buyers.

Landed aristocracies no longer dominate the political system, yet fiscal favoritism for real estate has never been stronger, precisely because property ownership has been democratized – on credit. Real estate accounts for some 70 percent of bank lending in Britain and the United States, making it by far the major market for bank loans, not industry and commerce as anticipated a century ago. This explains why the financial sector now stands behind real estate interests as their major lobbyist for property tax cuts. Mortgage interest now absorbs most of the land's "free" rental value, which is capitalized into debt overhead rather than serving as the tax base.

Voters have come to believe that their interest lies in lowering property taxes, not raising them. Homes are the major asset for most households, and real estate remains the economy's largest asset. Land is still its largest component – and some 80 percent of "capital" gains in the U.S. economy are land-price gains Site values are increased by public investment in streets, water and sewer facilities and transportation hubs, in school systems, by zoning restrictions, by the general level of prosperity, and most of all, by whatever bankers will lend.

Six variables are at work: (1) lower interest rates for capitalizing land rent into mortgage loans, (2) lower down payments, (3) slower rates of amortization (that is, giving borrowers longer to pay off the mortgage), (4) "easier" credit terms, i.e., looser standards for "liar's loans" and kindred, the more credit can be extended to bid up real estate prices.

Meanwhile, banks recycle their interest income into new loans – and also into campaign contributions to politicians who pledge to (5) lower property taxes, leaving more rental income to be paid to banks as interest to carry yet larger mortgage loans. Debt leveraging inflates property prices, creating (6) hopes for capital gains, prompting buyers to take on even more debt in the speculative hope that rising asset prices will more than cover the added interest, which is paid out of capital gains, not out of current income. [30]

Recent years are the first time in history that homeowners and indeed, entire economies have imagined that the way to get rich was to run deeper into debt, not to pay it down. Home ownership is the defining criterion for belonging to the middle class. Some two-thirds of the British and U.S. populations now own their own homes, and upward of 90 percent in Scandinavia. This diffusion of property ownership has enabled the propertied and financial interests to mobilize popular opposition to taxes on commercial and rental real estate as well as homes. (California's Proposition13 is the most notorious case in such demagogy.)

Government moves to check rentier interests are depicted as "the road to serfdom." Yet untaxing property and finance obliges governments to make up these tax cuts by raising taxes that fall on consumers and non-FIRE-sector business. This shrinks the economy, lowering its ability to pay the rent needed to pay the bankers on their mortgage loans. So we are brought back to the problem of debt deflation and the capitalization of interest charges into higher prices.

An income profile for the typical U.S. wage earner shows the degree to which the cost of living now reflects FIRE sector costs more than prices for commodities produced by labor. Some 40 percent of blue-collar wage income in the United States typically is spent on housing. (Recent attempts by the Federal Deposit Insurance Corp. to reduce the proportion absorbed by mortgages to 32 percent have encountered strong bank opposition.) Another 15 percent or so is earmarked to pay other debts: student loans to get the education required for middle class employment, auto loans to drive to work (from the urban sprawl promoted by tax shifts favoring real estate "developers"), credit card debt, personal loans and retail credit. FICA paycheck withholding ostensibly for Social Security and Medicare (a euphemism for the tax shift off the higher income brackets) absorbs 11 percent of payroll costs, and income and sales taxes borne by labor add another 10 to 15 percent.

This leaves only a third of wage income available to spend on food and clothing, transportation, health care and other basic needs. This has transformed the character of global competition, yet it is cognitive dissonance as far as academic theories of international trade and investment are concerned. Economics theorizing remains shaped by Ricardo's success at diverting attention away from the debt and financial overhead as a main economic problem.

This is not how matters were supposed to turn out for Progressive Era reforms of industrial capitalism. The fight to minimize rentier rake-offs in the form of economic rent from land, commercial monopolies, banking and kindred rent-seeking "tollbooth" privileges has failed. It has failed largely because of the symbiosis between the financial sector and the rent-seekers that have become its major customers as access to bank credit has been democratized.

On the broadest social level, the ostensible "free market" lobbying effort sponsored by banks to shift the property tax onto labor and industry has become a campaign against government itself. The aim is to shift planning – along with public enterprises and their revenue – out of the hands of public agencies to those of Wall Street in the United States, the City of London, the Paris Bourse, Frankfurt, Hong Kong, Tokyo and other financial centers.

The problem is that the vantage point of financial planners is more short-term than that of government. And being short-term, it is extractive, not productive.

Finance capital's raid on industry

Marx defined "primitive accumulation" as the seizure of land and other communally held assets by raiders and the subsequent extraction of tribute or rent. Today's financial analogue occurs when banks create credit freely and supply it to corporate raiders for leveraged buyouts or to buy the public domain being privatized. Just as the motto of real estate investors is "rent is for paying interest," that of corporate raiders is "profit is for paying interest." Takeover specialists and their investment bankers pore over balance sheets to find undervalued real estate and other assets, and to see how much cash flow is being invested in long-term research and development, depreciation and modernization that can be diverted to pay out as tax-deductible interest.

Whatever is paid out as income taxes and dividends likewise can be turned into tax-deductible interest payments. The plan is to capitalize the target's cash flow (ebitda) into payments to the bankers and bondholders who advance the credit to buy out existing shareholders (or government agencies). For industrial firms such leveraged buyouts (LBOs) are called "taking a company private," because its stock ownership is no longer publicly available.

Permitting interest to absorb the revenue hitherto paid out as taxes and (after-tax) dividends to stockholders is diametrically opposite to replacing debt with equity funding as Saint-Simon and subsequent reformers hoped to bring about. The logical end – and the dream of bank marketing departments – is for all cash flow – earnings before interest, taxes, depreciation and amortization – is to be paid out as interest, leaving nothing over for taxes, capital renewal and modernization to raise labor productivity and living standards. All land rent, corporate profit, tax revenue and personal income over and basic spending is to be pledged to banks and bondholders as interest.

Under such conditions fortunes are made most readily not by industrial capital formation but by indebting industry, real estate, labor and governments, siphoning off the economic surplus in interest, other financial fees, bonuses, and "capital" gains. Populations willingly go into debt as it appears that gains can be made most easily by buying real estate and other assets on credit – as long as asset prices rise at a pace higher than the rate of interest.

Today's financial investors aim at "total returns," defined as earnings plus capital gains – with increasing emphasis on the latter gains in real estate, stocks and bonds. Industrial companies increasingly are "financialized" to produce such gains for investors, not to increase tangible capital formation. The "bubble" or Ponzi phase of the financial cycle aims to create the financial equivalent of a perpetual motion machine, sustaining an exponential debt growth by creating enough new credit to inflate real estate, stock and bond prices at a rate that (at least for a while) enables debtors to cover the interest falling due. [31] As a recent popular phrase puts it, financial collapse is staved off by the indebted economy trying to "borrow its way out of debt."

This asset-stripping dynamic, which Marx characterized as usury capital, is antithetical to that of industrial capital. Based on the liabilities side of the balance sheet, financial securities take the form of anti-wealth – legalized claims on the means of production and income earned productively. The underlying dynamic is fictitious, because it cannot remain viable for long. It sustains interest payments by stripping assets, leaving the economy with less ability to produce a surplus out of which to pay creditors. And indeed, the financial sector destroys life on a scale similar to military conquest. Birth rates fall, life spans shorten and emigration soars as economies polarize.

This is the “free market” alternative to Progressive Era and socialist reforms. It typifies the IMF austerity plans that epitomize centralized planning on behalf of the global financial sector. Yet pro-financial ideologues depict public ownership, regulation and taxation as the road to serfdom, as if the alternative endorsed by Frederick Hayek, Ayn Rand and Alan Greenspan were not a road to debt peonage. And the endgame of this dynamic is a financial crash, wiping out savings that have been lent out beyond the indebted economy’s ability to pay.

It is at this point that the financial sector wields its political power to demand public bailouts in a vain attempt to save the preserve the financial system’s ability to keep on expanding at compound interest. Much as environmental polluters seek to shift the cleanup costs onto the public sector, so the financial sector demands cleanup of its debt pollution at taxpayer expense.

The fact that this is now being done in the context of ostensibly democratic politics throws a leading assumption of political economy into doubt. If economies tend naturally to act in their self-interest, how did the financial sector gain such extractive power to raid and dismantle industry and shed its tax burden?

If Darwinian models of self-betterment are to explain the past century’s development, they must show how creditors have translated their financial power into political power in the face of democratic Parliamentary and Congressional reform.

How has planning become centralized in the hands of Wall Street and its global counterparts, not in the hands of government and industry as imagined almost universally a century ago? And why has Social Democratic, Labour and academic criticism become so silent in the face of this economic Counter-Enlightenment?

The answer is, by deception and covert ideological manipulation via “junk economics.” Financial lobbyists know what smart parasites know: The strategy is to take over the host’s brain, to make it believe that the free luncher is part of its own body. The FIRE sector is treated as part of the economy, not as draining the host's nourishment. The host even goes so far as to protect the free rider, as in the 2008-09 bailouts of Wall Street and British banks at "taxpayer expense."

When such growth culminates in financial wreckage, banks demand public bailouts. They claim that this is necessary to enable them to resume lending. But they will not lend more against property already so deeply indebted that it remains in negative equity. Hoping to turn the crisis into an opportunity for further financial incursions into the industrial economy, bank lobbyists propose that governments help indebted homeowners and real estate investors avoid default by cutting property taxes yet further – shifting the fiscal burden yet more onto labor and non-financial business.

Tax cuts on wealth are promoted as if they will be invested rather than used to pay the financial sector more interest or be gambled on currencies and exchange rates, interest rates, stock and bond prices, credit default swaps and kindred derivatives.

Economic evolution does not necessarily follow the path of greatest efficiency. The oligarchic, creditor-oriented Roman Empire collapsed into the Dark Age, after all. Financially destructive policies may overwhelm technological potential. Bubble-type prosperity is based on debt-leveraged asset-price gains at the expense of the economy at large. Rising housing prices raise the cost of living, while rising stock and bond prices increase the cost of buying a retirement income – leaving pension funds unable to make good on their promises.

Pension-fund capitalism and other financial modes of exploiting labor

Finance capital's modes of exploiting labor go far beyond that of industrial capital employing it to sell its products at a profit, and even beyond simple usurious lending to labor (above all for housing). Most innovative has been the appropriation of labor's savings via pension funds and mutual funds. In the 1950s, General Motors and other large companies offered to contribute to funds to pay pensions in exchange for slower growth in wages. This policy (which Peter Drucker patronizingly called "pension-fund socialism") [32] turned over wage set-asides to professional money managers to buy stocks and junk bonds to make financial gains – but not in a manner that necessarily promotes industrial capitalism.

Money would grow through the proverbial "magic of compound interest," making money purely from money (M-M').

The dream is to manage labor's savings on a commission basis, steering it to inflate stock and bond prices. And indeed, pension-fund savings did fuel a stock market run-up from the 1960s onward. In the process, they provided corporate raiders and other financial managers with funds to use against labor – and against industrial capital itself. Pension fund managers played a large role in the junk bonding of industry in the 1980s. And finding themselves graded on their performance every three months, fund managers back raiders who seek to gain by downsizing and outsourcing labor.

They typically find their fortune (and even job survival) to lie in using pension savings not in ways that increase employment, improve working conditions or invest in productive capital formation, but in making gains purely by financial means – corporate looting that strips assets to pay dividends and increase short-term stock prices, or simply to pay off creditors.

Meanwhile, the largest sellers of stocks have been managers and venture capitalists "cashing out" by selling into a market fueled mainly by labor's wage set-asides. Pension funds thus turn out to play a key role in enabling finance capitalists to realize their gains – only to be their fate to be left holding an empty bag in the end. Selling off stocks to pay retirees creates an outflow of funds from the stock market that reverses the initial price run-up.

"Money manager" capitalism aims to financialize Social Security and Medicare along similar lines, sending a new tsunami of public funds into the stock market to produce capital gains. [33] A dress rehearsal for this plan was staged in Chile after its 1973 military coup. The Chicago Boys who advised the junta called it "labor capitalism," a cynical Orwellian term that Margaret Thatcher adopted for her program of privatizing Britain's public utilities. (The "labor" here represents the exploited party, not the beneficiary.) A slice of its wages is withheld and turned over to the employer's financial affiliate (the *banco* for the Chilean *grupos*). When a high enough pension reserve is accumulated, the employer transfers it to the *banco* or kindred affiliate in an offshore banking center, leaving the industrial employer a bankrupt shell.

The actuarial fiction is that corporate, state and local pension funds (and Social Security) invested financially can grow exponentially by enough to pay for retirement and health care. This goal cannot be met in practice, because the "real" economy is unable to grow at a rate required to support the growth in debt service. Widespread awareness of this fact has led to the corporate ploy of threatening bankruptcy if unions do not agree to replace defined-benefit pensions with defined-contribution programs in which all that employees know is how much is docked from their paycheck, not what they will end up with. General Motors went bankrupt as a result of its inability to fund the pensions guaranteed by their defined-benefit plans.

Financial claims rise exponentially, beyond the economy's ability to pay. Bubble economies try to postpone the inevitable crash by inflating prices for real estate, stocks and bonds by enough to enable debtors to take out higher loans against the property they pledge as collateral. Governments balance their budgets by privatizing public enterprises, selling "tollbooth" privileges on credit to buyers who bid up their prices by debt leveraging. Financial underwriters reap commissions and insiders making a killing as sales prices for stocks are underpriced to guarantee first-day price jumps. (Mrs. Thatcher perfected this ploy, making unprecedented fortunes for early players and underwriters in the privatization game.)

A crash occurs at the point where this disparity is widely recognized. To bankers, the antidote is to lend enough new credit to re-inflate prices real estate and other assets, enabling new buyers to borrow the credit to buy property from defaulters. Rather than scaling back the U.S. economy's over-indebtedness, for instance, the Treasury and Federal Reserve have bailed out the banks to save them from taking a loss on debt write-downs. [34] The dream is to keep the compound interest scheme expanding ad infinitum. But the pretense that fictitious finance-capital claims can be paid must be dropped at the point where financial managers desert the sinking financial ship. Their last act before the bubble bursts is the time-honored practice of taking the money and running – paying themselves as large bonuses and salaries as corporate treasuries (and public bailouts) allow.

Conclusion

Finance capitalism has become a network of exponentially growing interest-bearing claims wrapped around the production economy. The internal contradiction is that its dynamic leads to debt deflation and asset stripping. The economy is turned into a Ponzi scheme by recycling debt service to make new loans to inflate property prices by enough to justify yet new lending. But a limit is imposed by the shrinking ability of surplus income to cover the debt service falling due. That is what the mathematics of compound interest are all about.

Borrowing to make speculative gains from asset-price inflation does not involve tangible investment in the means of production. It is based simply on M-M’, not M-C-M’. The debt overhead grows exponentially as banks and other creditors recycle their receipt of debt service into new (and riskier) loans, not productive credit.

Half a century of IMF austerity programs has demonstrated how destructive this usurious policy is, by limiting the economy’s ability to create a surplus. Yet economies throughout the world now base their pension planning, medical insurance, state and local finances on a faith in compound interest, without seeing the inner contradiction that debt deflation shrinks the domestic market and blocks economies from developing.

What is irrational in this policy is the impossibility of achieving compound interest in a “real” economy whose productivity is being eroded by the expanding financial overhead raking off a rising share. Meanwhile, a fiscal sleight-of-hand has taken Social Security and Medicare out of the general budget and treated them as “user fees” rather than entitlements.

This makes blue-collar wage earners pay a much higher tax rate than the FIRE sector and the upper income brackets. FICA paycheck withholding has become a forced “saving in advance,” ostensibly to be invested for future “entitlement” spending but in practice lent to the Treasury to enable it to cut taxes on the higher brackets. Instead of financing Social Security and Medicare out of progressive taxes levied on the highest income brackets – mainly the FIRE sector – the dream of privatizing these entitlement programs is to turn this tax surplus over to financial managers to bid up stock and bond prices, much as pension-fund capitalism did from the 1960s onward.

A century ago most economic futurists imagined that labor would earn higher wages and spend them on rising living standards. But for the past generation, labor has used its income simply to carry a higher debt burden. Income over and above basic needs has been “capitalized” into debt service on bank loans used to finance debt-leveraged housing, and to pay for education (originally expected to be paid out of the property tax) and other basic needs. Although debtors’ prisons are a thing of the past, a financial characteristic of our time is the “post-industrial” obligation to work a lifetime to pay off such debts.

Meanwhile, the FIRE sector now accounts for 40 percent of U.S. business profit, despite the tax-accounting fictions cited earlier.

Financial lobbyists have led a regressive about-face toward an economic Counter-Enlightenment. Reversing an eight-century tendency to favor debtors, the bankruptcy laws have been rewritten along creditor-oriented lines by banks, credit-card companies and other financial institutions, and put into the hands of politicians in what best may be called a financialized democracy – or as the ancients called it, oligarchy. Shifting the tax burden onto labor while using government revenue and new debt creation to bail out the banking sector has polarized the U.S. economy to the most extreme degree since statistics began to be collected.

The Progressive Era expected planning to pass into the hands of government, not those of a financial sector at odds with industrial capital formation and economic growth. Nearly everyone a century ago expected infrastructure to be developed in the public domain, in the form of public utilities whose services would be provided freely or at least at subsidized rates in order to lower the price of living and doing business. Instead, public enterprises since about 1980 have been privatized – on credit – and turned into tollbooth privileges to extract economic rent. Bankers capitalize these opportunities, which are sold on credit.

Little is left for the tax collector after charging off interest, depreciation and amortization, managerial salaries and stock options. The resulting tax squeeze impoverishes economies, obliging governments either to cut back their spending or shift the fiscal burden onto labor and non-financialized industry.

The resulting financial dynamic is more like what Marx described as usury-capital than industrial banking. In the spirit of the Saint-Simonians he believed industrial capitalism to direct credit into productive capital formation, he expected that financial planning would pave the way for a socialist reorganization of society. Instead, it is paving the road to neoserfdom. Financial operators are using credit as a weapon to strip corporate assets on behalf of bankers and bondholders.

Employees can afford homes and other property (and indeed, entire corporations) only by borrowing the purchase price – on terms that involve a lifetime of debt peonage, and indeed (in most countries) bearing personal liability for negative equity when housing prices plunge below mortgage levels. Government planning has become subordinate to the dictates of unelected central bankers and the International Monetary Fund imposing austerity programs rather than funding capital formation and rising living standards.

Having analyzed finance capital's tendency to grow exponentially, Marx nonetheless believed that it would be subordinated to the dynamics of industrial capital. With an optimistic Darwinian ring he shared the tendency of his contemporaries to underestimate the ways in which the vested interests would fight back to preserve their privileges even in the face of democratic political reform. He expected industrial capitalism to mobilize finance capital to fund its expansion and indeed its evolution into socialism, plowing profits and financial returns into more capital formation.

It was the task of socialism to see more of this surplus spent on raising wages and living standards while improving the working conditions – and spent by government to freely provide an expanding range of basic needs, or at the very least at subsidized prices. Infrastructure spending and rising living standards thus would become the ultimate beneficiaries of capital formation, not landowners, monopolists or predatory finance.

This is not how matters have worked out. More of the economic surplus is being siphoned off as land rent and interest. Yet many of Marx's followers conflate his analysis of industrial capital with the financial dynamic of "usurer's capital." The latter is not part of the industrial economy but grows autonomously by "purely mathematical" means, running ahead of the economy's ability to produce a surplus large enough to pay the exponentially soaring financial overhead. [35]
And in contrast to his analysis of industrial capital, Marx explained why the financial overgrowth – recycling savings into new loans rather than investing them productively in tangible capital – cannot be sustained:

The credit system, which has its focus in the so-called national banks and the big money-lenders and usurers surrounding them, constitutes enormous centralisation, and gives to this class of parasites the fabulous power, not only to periodically despoil industrial capitalists, but to interfere in actual in a most dangerous manner – and this gang knows nothing about production and has nothing to do with it. [36]

Society therefore faces a choice between (1) saving the economy, by writing down debts to the ability to carry without stripping the economy; and (2) saving the financial sector, trying to preserve the fiction that debts growing at compound interest can be paid. For pensions and other public programs, for example, this means a choice between (1) paying them on a pay-as-you-go basis, out of the "real" economic surplus; and (2) the fictitious assumption that funds can earn annual returns of 8 percent or more to provide for labor's retirement by asset-price inflation fueled by debt leveraging and purely financial maneuvering (M-M').

If economic evolution is to reflect the inner logic and requirements of society's technological capabilities, then finance capital must be subordinated to serve the economy, not to be permitted to master and stifle it. That is what John Maynard Keynes meant by what he gently called "euthanasia of the rentier." In practice it means that governments must prevent property rents and other returns to privilege from being capitalized into bank loans.

To save society, its victims must see that asset-price inflation fueled by debt leveraging makes them poorer, not richer, and that financialization is the destroyer and exploiter of industrial capital as well as of labor. The objective of classical political economy was to bring prices in line with socially necessary costs of production. This was to be achieved in large part by taxing away economic rent in order to prevent it from being capitalized into loans to new buyers. Buying rent-extracting opportunities on credit increases prices for basic needs, turning society into a "tollbooth economy." It also forces governments to compensate by raising taxes on labor and tangible capital.

Many Social Democratic and Labour parties have jumped on the bandwagon of finance capital, not recognizing the need to rescue industrial capitalism from dependence on neofeudal finance capital before the older conflict between labor and industrial capital over wage levels and working conditions can be resumed. That is what happens when one reads only Volume I of Capital, neglecting the discussion of fictitious capital in Volumes II and III and Theories of Surplus Value.

Footnotes

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[1] A shorter version of this article was given in at the China Academy of Sciences, School of Marxist Studies in Beijing in November 2009, and at the Left Forum in New York City, March 20, 2010.

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[2] Theories of Surplus Value, Part III (Moscow: Foreign Languages Publishing House, 1971), p. 468.

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[3] Capital, Vol. III (Chicago: Charles H. Kerr, 1909), p. 710. All subsequent quotations from Capital are from this edition, unless specifically noted (as in footnotes 15 and 36).

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[4] Ibid., p. 705.

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[5] See for instance ibid., p. 700: 'In place of the old exploiters, whose exploitation was more or less patriarchal because it was largely a means of political power, steps a hard money-mad parvenu.'

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[6] Ibid., p. 716.

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[7] Ibid., pp. 699f.

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[8] Ibid., p. 711 fn. 116.

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[9] It is only in the English-language translations of Marx's Theories of Surplus Value III (1971, pp. 296f., 527-37) for instance, that one can find Martin Luther's denunciation of usurers, not in Luther's Works published by Fortress.

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[10] Capital III, p. 552.

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[11] In his Grundrisse notebooks, Karl Marx: Grundrisse, Penguin, London 1973, pp. 842f.) incorporated into Capital III (ch. xxiv), p. 463.

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[12] Capital III, p. 699.

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[13] 'Capitalism in the United States is now in a new stage, money manager capitalism, in which the proximate owners of a vast proportion of financial instruments are mutual and pension funds. The total return on the portfolio is the only criteria used for judging the performance of the managers of these funds, which translates into an emphasis upon the bottom line in the management of business organizations.' Hyman P. Minsky, 'Uncertainty and the Institutional Structure of Capitalist Economies,' Working Paper no. 155, Jerome Levy Economics Institute, April 1996, cited in L. Randall Wray, 'The rise and fall of money manager capitalism: a Minskian approach,' Cambridge Journal of Economics, Vol. 33 (2009), pp. 807-828, and also in Wray, 'Minsky's Money Manager Capitalism and the Global Financial Crisis,' 2010, http://www.levyinstitute.org/pubs/conf_april10/19th_Minsky_PPTs/19th_Minsky_Wray.pdf.

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[14] Capital III (Chicago, 1905), p. 713.

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[15] Capital III (Moscow: Foreign Languages Publishing House, 1958), p. 479.

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[16] Capital III, p. 461.

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[17] Ibid., p. 547.

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[18] Ibid., p. 548.

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[19] Ibid., pp. 551f. (Ch. xxix: The Composition of Banking Capital). The term fictitious capital passed into general circulation. In the United States it meant capitalized unearned income (‘economic rent,’ income without cost-value, mainly in the forms of groundrent and monopoly rent as well as financial extraction of revenue). Henry George picked it up in The Condition of Labour – An Open Letter to Pope Leo XIII, (1891) Henry George Foundation of Great Britain, London, 1930, referring to the ‘fictitious capital that is really capitalized monopoly’ (in The Land Question and Related Writings, New York, Robert Schalkenbach Foundation, 1982), pp. 201f.). Book 3, Chapter 4 of George’s Progress and Poverty (1879), William Reeves, London, 1884.) is titled, ‘Of Spurious Capital And Of Profits Often Mistaken For Interest.’

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[20] Capital II (Moscow: Foreign Languages Publishing House, 1957), p. 532.

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[21] It often surprises both ends of the political spectrum to learn that it was Marx who firmly established depreciation as an element of value theory. As Terence McCarthy wrote in his initial English language translation of Marx’s Theories of Surplus Value (which he translated under the title of A History of Economic Doctrines, New York: Langland Press, 1952, p. xv): ‘As a logical consequence of his examination of Physiocracy, Marx was led to a study of the Economic Theory of Depreciation. So complete is his analysis of this aspect of income formation that, if Capital has been called the bible of the working class, the History might well be called the bible of the Society of Cost Accountants. . . . Over the whole society, failure to provide adequate depreciation reserves is, Marx implies, to negate economic progress and to begin consumption of that portion of the value of the product which Marx believes belongs neither to the labourers in industry, nor to their employers, but to the economy itself, as something which must be ‘restored’ to it if the economic process is to continue.’

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[22] I discuss Ricardo's views and the more advanced response of his contemporaries in Trade, Development and Foreign Debt: A History of Theories of Polarization v. Convergence in the World Economy (2nd ed. ISLET 2010 [available on Amazon.com]; orig. pub. London: Pluto Press, 1992).

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[23] The Poverty of Philosophy [1847] (Moscow, n.d.), p. 155. Theories of Surplus Value III, pp. 396-98 quoted Antoine Cherbuliez, Richesse ou pauvrete (Paris: 1841), p. 128, whose title and content seems to have inspired Henry George's Progress and Poverty (1879): 'Rent thus would replace all state revenues. Finally industry, liberated, released from all fetters, would take an unprecedented leap forward . . .'

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[24] Socialism Vs. Single Tax. A Verbatim Report of a Debate held at Twelfth Street, Turner Hall, Chicago, December 20th, 1905. Chicago: Charles H. Kerr & Co., [1907], pp. 4f.

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[25] H. S. Foxwell, 'The Nature of the Industrial Struggle,' Economic Journal 27, pp. 323-27, and 'The Financing of Industry and Trade,' ibid., pp. 502-15).

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[26] Capital III, p. 714, quoting Religion saint-simonienne, Economie politique et Politique (Paris: 1831, p. 98 and 45). Marx cites the 1831 compilation Religion saint-simonienne describing banks as enabling 'industrious people' to obtain financing for their enterprise, and Charles Pecqueur, Theorie Nouvelle d'Economie Sociale et Politique (Paris 1842, p. 434) urging that production be ruled by what the Saint-Simonians called the Systeme general des banques.

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[27] Capital III, p. 711 fn. 116. Saint-Simon's weakness, according to Marx, was that of many land taxers, namely, his failure to see the antagonism between the bourgeoisie and the proletariat. He blamed this on the Fourierist desire to reconcile capital and labour, which Marx believed to be impossible.

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[28] George W. Edwards, The Evolution of Finance Capitalism (1938), pp. 16f.

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[29] Lloyd George called them 'the stronghold of reaction' (see Thomas Johnston, The Financiers and the Nation [London 1934, p. 138]). Ernest Bevin, G. D. H. Cole and other members of the British Labour Party criticized banks in The Crisis (London 1931). See also Cole, The Socialisation of Banking (London 1931), and John Wilmot, Labour's Way to Control Banking and Finance (London 1935). The Labour Party's proposed solution was to nationalize the Bank of England, and in 1933 to recommend socializing the joint stock banks as well. Keynes was sympathetic in 'A New Economic Policy for England,' Economic Forum, Winter 1932-33, pp.29-37.

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[30] I chart these variables in Michael Hudson, 'The New Road to Serfdom: An illustrated guide to the coming real estate collapse,' Harpers, Vol. 312 (No. 1872), May 2006):39-46.

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[31] Hyman P. Minsky accordingly called this the Ponzi phase of the financial cycle in 'The Financial Instability Hypothesis,' Levy Institute Working Paper No. 74, May 1992, and Stabilizing an Unstable Economy (New York: McGraw-Hill Professional, 1986).

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[32] Peter Drucker, The Unseen Revolution: How Pension Fund Socialism Came to America (New York: Harper & Row, 1976). See also Drucker's Post-Capitalist Society (New York: HarperBusiness, 1993), p. 77: 'Pension fund capitalism is fundamentally as different from any earlier form of capitalism as it is from anything any socialist ever envisage as a socialist economy.'

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[33] I trace this campaign in 'The $4.7 trillion Pyramid: Why Social Security Won't Be Enough to Save Wall Street,' Harpers, Vol. 310 (No. 1859, April 2005), pp. 35-40.

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[34] Since September 2008 the US Federal Reserve has engaged in 'cash for trash' swaps,

accepting junk mortgages at their nominal 'mark to model' values. The Treasury has printed bonds for their these swaps, and taken Fannie Mae and Freddy Mac onto its own balance sheet, giving public guarantees that 'taxpayers' will make good on all losses.

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[35] Capital III, p. 700

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[36] Capital III (Moscow: Foreign Languages Publishing House, 1958), p. 532.

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