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Notes on Finance Capital and Imperialism Today

1. A distinctive feature of the current phase of capitalism in its imperialist stage is the role of finance capital as an instrument to establish hegemony and facilitate the appropriation of surplus. While this has coincided with substantial increases in the share of surplus in world output and the size of the overall surplus, it has also created new contradictions within capitalism making it prone to periodic crisis, the most recent of which has been compared in scale with the Great Depression of the 1930s.

2. Finance capital consists of a range of institutions (such as banks, brokers, investment banks, hedge funds and insurance companies) that create a large and diverse set of financial instruments to mediate the flow of purely financial capital for profit. The era of globalization has been characterized by the overwhelming presence and pervasive influence of fluid finance capital over the economies of the world, both developed and developing. So strong has been this influence that the ability of national governments to pursue policies specifically suited to the needs of their own economic condition has been significantly diluted.

3. This rise to dominance of finance capital is, however, not the result of a slow and continuous growth in financial capital relative to productive capital of various kinds. Rather, capitalism in the developed industrial countries experienced a transformation in the 1970s, because the post-War Golden Age of capitalism involving large government expenditures and a welfare state could not be sustained and the system was afflicted by a crisis, especially in the United States, the leading imperialist power, in the late 1960s and early 1970s. After the Second World War and till that time capitalism could ensure high rates of growth, low unemployment and low inflation. This, however, came to an end in the 1970s, partly because wages were rising faster than productivity leading to price increases and partly because the prices of crucial primary commodities like oil could no longer be held down to ensure high growth with low inflation.

4. During the Golden Age, the state in the developed industrial societies, particularly in the United States had imposed a range of controls on banks, preventing them from using the money of ordinary depositors for speculative investments. To ensure the stability of the banking system, interest rates that could be paid to attract deposits into banks and interest rates that could be charged on lending to the productive sectors were regulated. Banks were not allowed to compete with each other to attract deposits by offering depositors higher interest rates, as this would encourage them to invest in risky areas where returns are higher to cover the higher costs of capital. On the lending side banks were restricted from charging interest rates of a kind that would make it difficult for investors to access credit for productive purposes. Bank profitability was guaranteed because of the margin between deposit and lending rates and credit for productive activity was ensured by curbing speculative activity on the part of banks.

5. This regulatory framework enshrined in the Glass-Steagall Act of 1933 was created to restore the viability of the banking system which had faced a major crisis with mass closures. It was designed to protect banks against failure by excluding them from competition of a kind that forces them to adopt risky strategies in search of larger business volumes and higher margins. The regulatory framework went even further to directly curb risky practices in the banking industry. Restrictions were imposed on investments that banks or their affiliates could make, limiting their activities to provision of

loans and purchases of government securities. There was a ban on banks underwriting securities and serving as insurance underwriters or agents, besides limits on outstanding exposure to a single borrower and lending to sensitive sectors like real estate. Finally, solvency regulation involved periodic examination of bank financial records and informal guidelines relating to the ratio of shareholder capital to total assets.

6. Not surprisingly, right through the period of intensive regulation of the financial sector in the US, finance was subordinate to industrial capital and there was little financial "innovation" in terms of new institutions or instruments, though there were periods characterized by substantial and rapid growth in the financial sector. In the 1950s, banking activity constituted 80-90 per cent of that in the financial sector. And even at the end of the 1950s, savings accumulated in pension and mutual funds were small and trading on the New York Stock Exchange involved a daily average of three million shares at its peak as compared with as much as 160 million shares per day during the second half of the 1980s.

7. With the comfortable conditions of the 1950s and 1960s coming to an end the US was hard put to keep inflation in check, since productivity was rising faster than wages. Between 1965 and 1972 consumer prices rose at double the previous average rate during peacetime for most of the century till then. Since the interest rates on time/savings deposits were fixed at three per cent and no interest was to be paid on demand deposits, savers faced negative interest rates, leading to demands for new instruments. Funds from the banks leaked out to securities markets. Banks themselves responded to the new situation by looking for new sources of finance and regulators were beginning to reduce controls on the banking system and relax caps on interest rates.

8. Once this crisis facing the US economy triggered the phase out of the regulated interest rate regime and launched a process of deregulation, a change in the institutional structure of the financial sector was inevitable with the removal of restrictions on banking activity. The process of dismantling of the walls separating different segments of the financial sector began in 1982. Banks were permitted to set up subsidiaries to engage in the brokerage business, to underwrite commercial paper and municipal revenue bonds, and issue mortgage-

and consumer loan-backed securities. The net result of these developments was a decline in the role of the banking business within financial markets. Regulation was also diluted to make way for regulatory 'forbearance'. Thus, by adopting a range of measures, the US state and federal governments and the Federal Reserve dismantled during the 1980s the system of regulation and the financial structure created by the policy framework put in place during and after the Great Depression.

9. At the centre of the new financial framework was a set of beliefs on how financial markets functioned and therefore should be regulated. Implicit in these beliefs was the idea that markets, institutions, instruments, indices and norms could be designed such that the financial system could regulate itself, getting off its back agencies that imposed structural and behavioural constraints to ensure the "soundness" of the financial system. The intervention of such agencies was seen as inimical to financial innovation and efficient provisioning of financial services. The principal form the new regulation took was the "capital adequacy ratio" or the requirement that they hold freely usable and available capital equal to 8 (or more) per cent of assets to cover losses and insure against financial failure. The size of this "regulatory" capital was computed not on the actual value of assets but on a risk-weighted proxy of that value. Risk-weighting would inflate the size of regulatory capital required as the share of more risky assets in the portfolio of banks rises. Since returns on freely accessible regulatory capital was low banks were expected to be discourage from holding too much by way of risky assets because that would lock up capital in forms that were near-barren. This system was to be made even more secure by allowing the market to generate instruments that helped, spread, insure or hedge against risks.

10. The transformation brought about by the new financial framework had many features. To start with, banks extended their activity beyond conventional commercial banking into merchant banking and insurance. Second, within banking, there was a gradual shift in focus from generating incomes from net interest margins (or the difference between deposit and lending rates) to obtaining them in the form of fees and commissions charged for various financial services. Third, related to this was a change in the focus of banking activity as well. While banks did provide credit and create assets that

promised a stream of incomes into the future, they did not hold those assets till maturity any more, as they used in the past in the so-called "originate-and-hold" model. Rather they bundled them into pools, attached those bundles to particular securities eligible for the stream of incomes due from the underlying assets, and sold these securities for a fee to institutional investors and portfolio managers. Banks transferred the risk for a fee, and those who bought into the risk looked to the returns they would earn in the long term. This was the "originate and distribute" model of banking. It meant that those who originated the credit assets tended to understate or discount the risks associated with them. Moreover, since many of the securities created on the basis of these credit assets were complex derivatives, the risk associated with them was difficult to assess. The role of assessing risk was given to private rating agencies, which were paid to grade these instruments according to their level of risk and monitor them regularly for changes in risk profile. Fourth, the ability of the banking system to "produce" credit assets or financial products meant that the ultimate limit to credit was the state of liquidity in the system and the willingness of those with access to that liquidity to buy these assets off the banks. Within a structure of this kind periods of easy money and low interest rates increased the pressure to create credit assets and proliferate risk. Fifth, financial liberalization increased the number of layers in an increasingly universalized financial system, with the extent of regulation varying across the layers. Where regulation was light, as in the case of investment banks, hedge funds and private equity firms, financial companies could borrow huge amounts based on a small amount of own capital and undertake leveraged investments to create complex products that were often traded over the counter rather than through exchanges. Finally, while the many layers of the financial structure were seen as independent and were differentially regulated depending on how and from whom they obtained their capital (such as small depositors, pension funds or high net worth individuals), they were in the final analysis integrated in ways that were not always transparent. Banks that sold credit assets to investment banks and claimed to have transferred the risk, lent to or invested in these investment banks in order to earn higher returns from their less regulated activities. Investment banks that sold derivatives to hedge funds, served as prime brokers for these funds and therefore provided

them credit. Credit risk transfer neither meant that the risk disappeared nor that some segments were absolved from exposure to such risk.

8. That this complex structure which delivered extremely high profits to the financial sector was prone to failure has been clear for some time. For example, the number of bank failures in the United States increased after the 1980s. During 1955-81, failures of US banks averaged 5.3 per year, excluding banks kept from going under by official open-bank assistance. On the other hand during 1982-90 failures averaged 131.4 per year or 25 times as many as 1955-81. During the four years ending 1990 failures averaged 187.3 per year. The most spectacular set of failures, was that associated with the Savings and Loan crisis, which was precipitated by financial behaviour induced by liberalization. Each time a mini-crisis occurred there were calls for a reversal of liberalization and increased regulation. But financial interests that had become extremely powerful and had come to influence the US Treasury managed to stave off criticism, stall any reversal and even ensure further liberalization. The view that had come to dominate the debate was that the financial sector had become too complex to be regulated from outside; what was needed was self-regulation.

11. As this new liberalized framework unfolded, the size and influence of Finance Capital globally also increased. A number of parallel developments strengthened this process. The formation of OPEC and the oil shocks of the 1970s changed the global scenario with regard to financial balances. Since surpluses earned by the oil exporting countries were held in the main as deposits with the international banking system controlled in the developed world, the private financial system there became the powerful agent for recycling surpluses. This power was indeed immense. Surpluses deposited with the banking system led to a credit boom in the developed countries. The resulting increase in demand increased expenditure on oil and increased surpluses earned by the oil exporters even further. These surpluses were once again deposited with the transnational banks. They, in turn, offered further doses of credit that increased energy demand and oil surpluses even more. By 1981, OPEC countries are estimated to have accumulated surpluses to the tune of $475 billion, $400 billion of which was parked in the developed industrial nations.

12. Two other developments contributed to the increase in international liquidity during the 1970s and 1980s. First, the United States had exploited the fact that it was home to the world's reserve currency—the dollar that was as good as gold—to build up large international liabilities during the Bretton Woods years, including those resulting from expenditures on the Vietnam War and its policing efforts elsewhere in the world. International confidence in its currency allowed the US to ignore national budget constraints on its international spending and resulted in the global accumulation of dollar surpluses and the emergence of strong banking and financial interests with an international agenda.

13. A second factor was the changing demographic structure in most of the advanced countries, with members of the post-War generation reaching the age when they would emphasize personal savings for retirement. This generated a growing demand for more variety in savings instruments as well as higher returns, leading to the greater significance of pensions funds, mutual funds and the like. The net result of these and other developments was the burgeoning of finance.

13. How large is finance today? Given the diversity of agents, instruments and markets, it is extremely difficult to gauge the size of the capital that functions as international finance. Nevertheless, available figures do point to galloping growth in the global operations of financial firms. One obvious form this has taken since the international lending boom of the late 1970s is the expansion of operations of international banks in less developed countries, especially the so-called "emerging markets". The net result has been an increase in the international assets of the big banks of the developed world. This trend has only gained strength in recent years. At the time of the East Asian crisis (mid-1997), the international asset position of banks resident in 23 countries reporting to the Bank of International Settlements stood at $9.95 trillion, involving $8.6 trillion in external assets after adjusting for local assets in international currencies. By June 2007, when 40 countries were reporting, this had risen to $33.71 trillion, with external assets totalling $29.98 trillion. This trend characterised countries that reported on both dates as well. For example, the international assets of UK-based banks had increased

from $1.5 trillion to $6.1 trillion, and that of US banks from $0.74 trillion to $2.8 trillion.

15. With global liquidity increasing in this fashion, banks whose profits depend on keeping capital moving had to expand their universe of borrowers hugely. Securitisation that bundled credit assets together for transfer to investment banks, pension funds and insurance companies for a fee encouraged large scale lending since the original lender did not carry the credit risk. So lending for housing, automobile purchases and retail spending increased substantially. Housing credit grew rapidly because of easy access to credit, with even borrowers with low creditworthiness scores, who would otherwise be considered incapable of servicing debt, being drawn into the credit net. These sub-prime borrowers were offered credit at higher rates of interest, which were sweetened by special treatment and unusual financing arrangements—little documentation or mere self-certification of income, no or little down payment, extended repayment periods and structured payment schedules involving low interest rates in the initial phases which were "adjustable" and move sharply upwards when they are "reset" to reflect premia on market interest rates. All of these encouraged or even tempted high-risk borrowers to take on loans they could ill afford, either because they had not fully understood the repayment burden they were taking on or because they chose to conceal their actual incomes and take a bet on building wealth with debt in a market that was booming.

16. Mortgage lenders or brokers were encouraged to do this because they could easily sell their mortgages to banks and the investment banks in Wall Street to finance their activity and make a neat profit. And the investment banks themselves were keen to buy into the business because of the huge profits that could be made by "securitizing" these mortgages. Firms such as Lehman Brothers, Bear Stearns, Merrill Lynch, Morgan Stanley, and others bought into mortgages, pooled them, packaged them into securities and sold them for huge fees and commissions.

17. In sum, this whole process, which has at the bottom home owners, is driven by layers of financial interests looking for quick profits or high returns. However, when defaults began the market for housing collapsed and a crisis ensued. Moreover, the housing market

crisis was transformed into a crisis of the US financial sector, resulting in a liquidity crunch that precipitated a recession. All this has occurred also because of the regulatory forbearance that has characterized the ostensibly "transparent" but actually opaque markets that are typical of modern finance. Investment banks did not reveal the week credit base on which the mortgage securities business was built, investment analysts routinely issued reports assuaging fears of a meltdown, credit rating agencies did not downgrade junk bonds soon enough, and the market regulators chose to look the other way when the speculative spiral was built. With high returns on creating these products and facilitating trade in them, the investment banks were hardly concerned with due diligence about the underlying risk associated with these securities. That risk mattered little to them since they were transferred to the purchasers of those securities. The risks in the final analysis are shared with pension funds and institutional investors which were buying into these securities, looking for high returns in an environment of low interest rates.

18. Thus, underlying the recent crisis were two consequences of the developments outlined above. First, the "originate-and-distribute" model migrated out of the banking system to other segments of the financial sector. Second, this was facilitated by the fact that in more ways than one this resulting diversification and proliferation of Finance, was financed with massive borrowing by the liberalized banking system. Because of this complex chain, institutions at every level assumed that they were not carrying risk or were insured against it. However, risk does not go away, but resides somewhere in the system. And given financial integration, each firm was exposed to many markets and most firms were exposed to each other as lenders, investors or borrowers. Any failure would have a domino effect that would damage different firms to different extents. It was for this reason, we now know, that while the problems began with defaults on subprime loans, the crisis soon afflicted the core of the financial structure: the banking sector.

19. Behind all of this is a fundamental tendency: the rapid increase in financial wealth looking for new and profitable avenues for investment. This burgeoning of finance is itself the result of the wealth and income inequalities generated by the process of corporate globalization. Across the world corporate profits and rentier incomes

are rising rapidly, even as real wages stagnate or rise marginally, resulting in a rise in the share of surplus in national income. Such global and national inequalities concentrate incomes among a few, whether they be the millionaires in the developed and developing world who accumulate savings looking for avenues of investment or sections of the middle class that accumulate financial capital through investments in mutual and pension funds, that need to be invested to meet future commitments. Neo-liberal reform by reducing State provisions for social security only aggravates this process, since it requires the middle class to save for contingencies or old age. The financial component of neo-liberal reform permits pension funds and insurance companies to invest this capital in a wider range of assets, resulting in the expansion of an asset class like private equity. The financial system adjusts by courting risk.

20. The reason this process was sustained for long was that this kind of financial expansion spurred a real economy boom. The housing market in the US has been crucial to sustaining growth in the US ever since the dotcom bust of 2000. Galloping housing purchases stimulated residential investment and rising housing asset values encouraged a consumption splurge, keeping aggregate investment and consumption growing.

21. Thus the growth, proliferation and global spread of finance has been accompanied by increased financial fragility, leading to periodic episodes of financial crises. A financial crisis is seen as occurring when the inability of one or a group of economic agents to meet commitments to creditors or investors in financial instruments leads to bankruptcies and/or the sale of assets, which in turn results in the collapse of asset prices and threatens the financial viability of related enterprises. Most often the event is accompanied by a freezing or slowing of the flow of credit that adversely affects the real economy. There have been a number of instances of financial crises throughout the history of capitalism. But concern over the phenomenon has increased substantially over the last three decades as a result of an in the increase in the periodicity and intensity of such crises when compared to the period between World War II and the early 1980s. There are many forms that a financial crisis can take. It could, for example, take the form of a run on a group of banks resulting from a collapse of confidence in their ability to redeem deposits on demand

because of the weaknesses of their balance sheets. It could appear in the form of a dramatic collapse in stock market valuations because of a flight out of equity, most often in the wake of an equally dramatic boom in stock values. It could be reflected in the actual or potential default on interest and amortization payments due on the external debt owed by a country or its private sector. Or, it could entail the collapse of a currency because of a speculative attack triggered by signs of difficulty a country is facing in obtaining the foreign exchange needed to meet commitments denominated in those currencies.

22. From the point of view of the developing countries, the massive expansion of finance capital has been accompanied by a substantial increase in capital flows to developing countries. Net external financing flows which had fallen from $360.1 billion in 1997 to $173.5 billion in 2002, have since risen sharply to $785.5 billion in 2006. While foreign direct and portfolio investment increased from $153.8 billion in 2002 to $446.7 billion in 2006, net external borrowing rose from $10.9 billion in 2001 to 294.5 billion in 2006. Thus, underlying the surge was an expansion in both investment and debt flows to developing countries.

23. These flows were facilitated by financial liberalization in these countries. There are three broad effects that the process of financial liberalization has: (i) it opens the country to new forms and larger volumes of international financial flows, in order to attract a part of the substantially increased flows of financial capital to the so-called "emerging markets" since the late-1970s; (ii) to facilitate these inflows it liberalizes to differing degree the terms governing outflows of foreign exchange in the form of current account investment income payments and in the form of capital account transfers for permitted transactions; and (iii) it transforms the structure of the financial sector and the nature and operations of financial firms in a manner that makes the financial system resemble that in countries like the US and the UK.

24. It is now widely accepted that the first two of these, involving liberalization of controls on inflows and outflows of capital respectively, have resulted in an increase in financial fragility in developing countries, making them prone to periodic financial and currency crises. Analyses of individual instances of crises have tended to conclude that the nature and timing of these crises had much to do with the shift to a more liberal and open financial regime. What is

more, crises rarely lead to controls on capital inflows and reduced dependence on them. Rather adjustment strategies emphasise further financial liberalization, resulting in a history of periodic financial failure.

25. The 1997 crises in East Asia and subsequent crises in many other developing countries have focused attention on a number of dangers associated with a world dominated by fluid finance. In particular, they have sent out the message that if countries choose to liberalize their financial policies to attract financial investors to their markets, they were prone to boom-bust cycles, with adverse implications for the real economy. Underlying these financial cycles were speculative tendencies fostered by financial liberalization and globalization. These tendencies rendered global financial institutions prone to over-exposure in individual markets often as a result of unsound financial practices. A combination of the competitive thrust for speculative gains on funds garnered from profit-hungry investors, the herd instinct characteristic of financial investors, and the moral hazard generated by an implicit guarantee from the State that the financial system would be bailed-out in periods of crisis, all resulted in a situation where lending to and financial investments in particular countries continued well after there was evidence that high-risk exposure had exceeded warranted limits. The corollary of this was that supply-side factors were likely to result in boom-bust cycles in financial flows to developing countries, with a surge in such flows followed in all likelihood by a sudden collapse of such flows.

26. The problem is that the crises resulting from this process do not remain restricted to the financial sector. When the surge in capital flows is reversed, a massive liquidity crunch and a wave of bankruptcies follow. This results in severe contraction of spending in these countries, with attendant consequences for employment and the standard of living. Asset prices collapse and pave the wave for international acquisitions of domestic firms at low prices denominated in currencies that have substantially depreciated. A crisis triggered by finance capital becomes the prelude for conquest by international capital in general, with substantial changes in the ownership structure of domestic assets without much greenfield investment.

27. Associated with the rise of Finance is the rise to dominance of neoliberal ideology. Neoliberalism is of course an ambiguous and

loosely defined term, even when restricted to the economic sphere. So it would be useful to clarify the sense in which it is being used in this context. In what follows, neoliberal theory and practice are taken as referring to: (i) support for market fundamentalism, in which the ostensibly "free" market is presented as the most efficient mechanism to drive the economic system, so as to pave the way for the increasingly unfettered functioning of private capital, both domestic and foreign; (ii) the use of the notion of a minimalist state to legitimise the shift of income and asset distribution in favour of the owners of capital and their functionaries and conceal the conversion of segments of the state apparatus into sites for primitive accumulation; and (iii) the pursuit of a regime of accumulation where, the home market and deficit-financed state expenditure are replaced by exports and debt-financed private expenditure as the principal stimuli to growth.

28. As has been noted often, the rise of neoliberalism has been coterminous with the rise to dominance of finance in the developed industrial world and the global economy. Neoliberalism and financial globalisation feed on each other. Since the liberalisation of trade and of the rules governing the cross-border flows of capital result, in the first instance, in a widening of the trade and current account in the balance of payments of the liberalising economy, access to foreign capital to finance that deficit is a prerequisite for "successful" liberalisation that is not aborted by a balance of payments crisis. Thus, the pursuit of a neoliberal economic strategy is infeasible in a world where the access to international finance to developing countries is severely limited. On the other hand, foreign capital favours environments where markets and private capital are allowed free rein. Once trade and investment rules are liberalised to attract foreign capital, domestic controls on the operations of capital need to be diluted or dismantled. This includes controls on the operation of financial markets and firms with implications for the financial system and economic structure.

29. The neoliberal order has associated with it a set of outcomes that lend credibility to the Left agenda. It leads to periodic crises of varying intensity, triggered by developments in capital, credit and/or currency markets, resulting in slow growth, rising unemployment and increased deprivation. The livelihood of those dependent on agriculture, which is home to much of the labouring poor, deteriorates

and is even endangered. The free rein given to private capital results in predatory practices, as in forestry and the mining industry for example, that has devastating effects on the already poor and the marginalised. It alters the form and curtails the volume of state spending, adversely affecting the degree to which the welfare expenditures of the state can redress these negative outcomes for a large section of the population. Overall, a neoliberal trajectory implies that the surpluses extracted from the productive sectors increase, damaging the livelihoods of the working people engaged in these sectors. The fact that even in the case of countries successfully pursuing a neoliberal trajectory, such as India, decent jobs are scarce and inequality and poverty are on the rise, discredits this path of capitalist development.

30. There are new challenges that the neoliberal order creates for the Left in the developed and developing countries. Most importantly, neoliberal development weakens the "vanguard" in multiple ways. Principally, the numbers of the organised working class does not increase. Within wage employment, organised employment in environments that favour the growth of collective consciousness is the exception. Even high GDP growth is not accompanied by any noticeable expansion of decent work opportunities for the relatively younger labour force, especially in manufacturing. Increasingly, the manufacturing sector's contribution to organized employment not stagnates and even declines. In sum, even when employment is in the organised sector, the nature of employment becomes informal and insecure, encouraging workers to turn away from unionisation and even organised protest.

31. The effect of all this is visible in the stagnation of the real wage in the organised industrial sector at a time when productivity is rising rapidly. This has meant a sharp fall in the share of wages in value added in the organised manufacturing sector, which is where the traditional vanguard class of the Left resides. Not surprisingly, unionism is on the decline and the effort to organise workers even to fight economic struggles, let alone transcend them, is proving increasingly difficult. This is of significance because the conditions of workers in the organised sector provided the benchmark for where wages and working conditions should move towards. If those conditions stagnate and deteriorate the task of mobilising the

unorganised, which has become structurally crucial for the advance of the Left, is that much more difficult.

32. Finally, with the still continuing "success" of neoliberalism, sections of the so-called Centre, including those in the judiciary and the media, tend to adopt the discourse of the Right rather than of the Left. Increasingly it is not just the path but the objectives of development that are seen differently from the Left by much of the intelligentsia. Despite lack of supporting evidence, a view has gained ground that if the neoliberal project could be appropriately tweaked to suit county characteristics and high growth ensured for, say, a decade, then the exit out of underdevelopment is ensured. Inequality may increase, but poverty can be dealt with through public action. This departure from a Left perspective has been aided by the fact that in its phases of success, neoliberalism is able to and even relies on an expansion of consumption among the upper middle classes. Even when offered "contractual" employment with self-funded social security, leading sections of the middle class are bought off with high salaries and opportunities for credit-financed consumption. That offer is not the result of largesse to the middle class, but is part of the change in the regime of accumulation in neoliberal strategies, which has as its fall-out the cooption of a section of the erstwhile middle class. This deprives the Left of the support of some of the most vocal and articulate voices of dissent and protest it relied on in the past.

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