The new rules of Big Money

By Martin Thomas

NEVER in the history of industrial capitalism have the interest rates charged by banks and other financial centres on loans to business been so high and so erratic for so long.

British interest rates drifted mostly downwards from about 5 per cent to 4 per cent between 1800 and 1933, were rammed down to around 2 per cent between 1933 and 1946, rose steadily to about 8 per cent by 1970, rocketed to around 10 to 15 per cent in 1973-86, and have settled back only to 7 per cent or so. US interest rates show a broadly similar pattern[1].

Between the mid-'60s and about 1981, the rising interest rate raced against rapid price inflation. It only just won, and in the mid-1970s it lost. A bank lending $100 at interest might get back $115 a year later, but that $115 would buy less than the $100. After 1982, interest rates moved clearly ahead of dwindling inflation. Over the years 1980-95, the average rate for lending to big companies was 10.3% in the US, 10.7% in the UK. It outstripped inflation by 5.5% in the US, 5.1% in the UK (1985-95).

International flows of finance have grown fast, and short-term flows beyond precedent. International bond issues rose from $38 billion in 1980 to $461 billion in 1995; international loans from $78 billion to $372 billion[2]; the business of swapping large stashes of cash from one currency into another, to find the one which keeps its value best or offers the best interest rate, has grown in volume to maybe twenty times world trade.

High finance is king in the capitalism of the 1980s and '90s, probably more so than even in the era before World War 1 which first prompted Marxists and radicals to talk of "finance capitalism".

That is the background to the decision by Gordon Brown, Chancellor in the new Labour government elected in Britain on 1 May, to give the Bank of England power over interest rates — that is, in practice, authority to keep interest rates high and money tight whatever Parliament or people want. Many other countries, from New Zealand to France, have given their central banks the same dictatorial power in recent years. The trend is fixed in the European Union's Maastricht Treaty of 1991, which calls for a European Central Bank, and central banks in all European Union countries, independent of elected control. Each government, anxious to keep the fickle favour of the international finance markets, tells the financiers: look, we're safe, we have hard-headed central bankers who can and will keep moneylenders' incomes high whatever the clamour from the jobless and homeless.

II

CAPITAL is value in constant movement from one form to another: from money to means of production and labour-power to products to money. .. It has to hurry. It cannot wait for cumbersome transfers of gold coins. It needs credit. Capitalist businesses buy from and sell to each other on credit, deposit their spare cash with and draw credit from the banks, and accept cheques to settle accounts.

Yet promises to pay are never as good as actual payment. Every day cheques bounce, businesses fail and break their promises. Banks can fail too. The "thirty years after the end of the Second World War [was] a period of calm most unusual in the long sweep of banking history... But then came the great change with the ending of fixed [exchange] rates and the freeing of monetary policy and the banking system... Banking problems... have become larger in every business cycle since then".[3] Many big banks looked very shaky after Mexico stopped payments on its foreign debt in 1982. Continental Illinois, the USA's 8th-largest bank, collapsed in May 1984. In the early 1990s, over 1,000 savings and loans companies collapsed in the USA, owing hundreds of billions of dollars. The Bank of Credit and Commerce International was shut down in July 1991 as fraudulent and hopelessly insolvent. Japan's big banks have been technically insolvent in recent years because of huge losses on property deals.

Credit has limits. Suppliers reserve the right to demand cash payment; bank-account holders reserve the right to demand cash.

All debts can by law be cleared by payment in national bank notes and coin. Yet a national bank note is no more than a promise from the government. In Russia today, for example, roubles do not count as "hard cash" for many purposes.

In 19th century capitalism the last resort was to gold. Bank of England notes could, if you insisted, be exchanged for gold. Labour could be provisionally "validated" — recognised as social value-creating labour — by promises to pay from businesses or banks, but was finally validated by being equated with gold-producing labour.

Since World War 1, arguably, and certainly since 1971, when the US government dropped its promise to convert dollar notes to gold, the gold backstop no longer exists. There is no longer "hard cash" any harder than US dollars, the basic international reserve currency. Since the 1980s, central banks have been selling off their gold reserves, or using them for commercial operations.

Now labour is "pseudo-validated" by being equated with an approximate quantum of present and future average US labour. Thus "the diffuse form in which monetary constraints operate within credit money. In place of the opposition between the commodity and gold, there is a hierarchical structure of credits and debts..."[4]

This is a very flexible system, but also a delicate one. "The central bank", as Marx put it, "is the pivot of the credit system"[5], so the vast expansion since the 1970s of the fluidity and speed of credit puts central banks to the front of the capitalist scene.

III

THE Bank of England, the oldest major central bank in the world, was set up in 1694, shortly after the Glorious Revolution of 1688 which consolidated a bourgeois, parliamentary-controlled state in England, in a break from the old semi-feudal state based on the personal power of the king and the great lords. Previously the state budget had merged into the personal budget of the king and his hangers-on. Now it became an impersonal, bureaucratic, affair, geared to the increasing public provision of communications, law and services necessary for capitalism.

At its start the Bank of England was a private company, owned and run for profit by a group of merchants who had given the government a loan in return for legal privileges which included the right to issue banknotes. In the 19th century, as the state machine grew in financial and bureaucratic weight, legislation turned the Bank into something more like a government department, and large commercial banks developed alongside it.

There was much fumbling. The Bank Act of 1844, which tied the sum of banknotes the Bank could issue closely to its gold reserves, was — as Marx showed, in a scornful dissection[6] — based on great confusion of economic theory, and had to be suspended in the crises of 1847 and 1857. Yet the Bank became "the pivot" of an increasingly extensive system of credit, and a model for the central banks set up elsewhere — Spain 1782, France 1800, Netherlands 1814, Germany 1876, Japan 1882, Italy 1893, USA 1913.

The central banks would issue notes and coins. They would regulate the commercial banks' creation of additional money in the form of bank-account balances, by inspecting their books and (usually) demanding that the banks keep some fraction of their deposits at the central bank. When banks failed, they would rescue them, or at least compensate depositors. They would set an interest rate for lending cash short-term to the commercial banks, and shape longer-term interest rates by buying and selling government bonds (pieces of paper carrying a promise by the government to pay a certain level of interest).

However, in the era when all important currencies were fixed to a gold standard, when the pound was the basic currency of world trade, and British industry was strong enough to carry that weight, central banks had a relatively quiet life. After two experiments in the early 19th century, the USA was able to do without one until 1913.

World War 1 disrupted the gold standard. In a world, after 1918, where British industrial and financial supremacy had been broken, and relationships and proportions were much less stable, it could not be restored. Central bankers held conferences, and set up the Bank for International Settlements in 1930. Montague Norman, Governor of the Bank of England from 1920 to 1944, campaigned for central banks to be independent from elected governments.

Central bankers did more, and blundered more. Germany saw the world's first great hyperinflation, when between July and November 1923 prices went up by a factor of 850,000. Britain's banker-driven policy of returning to the gold standard in 1925 caused great damage before it was abandoned in 1931. The USA's central bank, the Federal Reserve, worsened the slump after 1929 by restricting credit. World trade collapsed.

Between 1945 and 1971 a sort of gold standard was restored, based on the dollar. The nationalisation of the Bank of England in 1946 was part of a trend. Before 1936, only five European central banks were state-owned. By 1994, all except nine of the world's 170 central banks were state-owned. Central banks went back to being technical agencies of government, as they had been before 1914 but on a far bigger scale.

Now, with the system in flux, the bankers come forward again to say: Attention! Money is fundamental. It is too important to be dealt with by elected governments. Leave the decisions to us!

IV

THE dollar is "hard cash" today because it can buy the products of US labour, and that labour produces a vast range of goods and services at the highest levels of productivity. The increased importance of the dollar, without help from gold, arises however not from a strengthening of its economic base in production but from a decline of the US relative to other big capitalist economies.

In the 1960s the USA pumped out dollars to pay for overseas purchases (especially for the Vietnam war) in excess of its income from exports. These "Eurodollars" piled up in bank accounts outside America. By using this pool, international financiers could operate largely free from control by any national government. Losing confidence in the US economy in 1968-71, they had sufficient clout to drive the US government to the conclusion that the official guarantee of the dollar (one ounce of gold for $35) was a dangerous fiction which must be abandoned. The pool increased vastly after the big oil price increase of 1973-4, as extra dollars paid to the oil-exporting states were deposited in metropolitan banks.

Meanwhile, the giant multinational corporations had grown steadily in size and scope, moving ever-vaster sums of money across national borders. Successive, and cumulatively dramatic, cheapening and speeding-up of international communications and transport increased the need for and speed of international credit. National credit markets had also expanded with the rapid growth of government debt: Britain's almost doubled between 1960 and 1975, a rate of increase never seen before except in war.

The newly fluid and free-floating international credit regime produced chaos in the 1970s, with rapid inflation, swings in exchange rates, and an alarming slump in the value of the dollar in 1978.

After 1979, as a new industrial recession bit, governments and bankers acted to harden up the regime. Their motto might have been Marx's comment: "A depreciation of credit-money would unsettle all existing relations. Therefore, the value of commodities is sacrificed for the purpose of safeguarding the fantastic and independent existence of this value in money. As money-value, it is secure only as long as money is secure. For a few millions in money, many millions in commodities must be sacrificed. This is inevitable under capitalist production and constitutes one of its beauties"[7].

They have evolved a regime which is stabilised, to a degree and at a miserable level, by the will (forged by fear) of each government and central bank to cut state spending and borrowing, and push up interest rates, enough to safeguard its currency.

Sweden in 1990 showed the brutality and the bias of this regime. "Under intense pressure from overseas financial opinion that forced up interest rates... and led to a huge outflow of capital from Sweden" — so the *Financial Times* reported (29.10.90) — "the Swedish government [had] to abandon a long-held... commitment to full employment and... the Welfare State. The international money markets have become the arbiters of Sweden's future, not the Social Democratic ideologues..." Unemployment in Sweden rose rapidly from almost nil to around 10%.

The regime has only limited stability. The international spiral of free-floating promises of payment is now so large that its flows and surges could overwhelm even the most banker-friendly government's attempts to ensure that its currency remains an effective means of payment. Hence the European Union's anxious moves to create a single Euro-money; hence the US ruling class's obsession with cutting the deficits on its government budget and its balance of payments.

In October 1979 the US Federal Reserve pushed a key interest rate to its highest-ever level, 12%, and kept it there, or higher, until 1982, despite record bankruptcies. Other major capitalist states followed suit. They had the nerve to do this because the working-class militancy of the 1970s had started to dissipate without decisive victories. They evolved their new regime fumblingly, without a clear scheme. In the first few years, up to about 1983, they were influenced by the soon-discredited dogma of "monetarism", which brought many disasters.

Yet milder methods of control were being scrapped. Fixed exchange rates between currencies were too difficult to hold in the maelstrom, as the collapse of the European Exchange Rate Mechanism in 1992 illustrated. The exchange controls which limited movements of funds from one currency to another up to the late 1970s were increasingly overwhelmed by the new international financial markets. Once some states discarded those controls, others quickly followed suit, because no-one would hold any more wealth than they had to in a currency which they might have trouble getting out of.

The new regime was locked into place by the fast growth of international finance flows, and also by the international restructuring of capitalist industry. Industries once central in each major national economy — coal-mining, steel — became less central and saw their major production centres shift to new countries. The textiles, clothing and footwear industries shifted too, to different sites. Microelectronics and information technology became major industries, and transformed other industries. These developments were driven by the low profit rates of the 1970s and '80s, and made possible by previous defeats for the working class, which they then compounded. The accompanying waves of bankruptcies, industrial collapses, takeovers, mergers, new ventures, retooling and redevelopment, increased the capitalist appetite for heavy and expensive credit.

V

BANKS can thwart a capitalist government whatever its authority on paper. The 1945 Labour government had to retreat considerably on its intent to keep interest rates low, because otherwise it could not shift the government bonds it needed to sell to pay compensation to the old owners of the industries it nationalised. In his memoirs of the 1964-70 Labour government, Harold Wilson reports that as early as November 1964 "we had reached the situation where a newly-elected government with a mandate from the people was being told, not so much by the Governor of the Bank of England but by international speculators, that the policies on which we had fought the election could not be implemented; the Government was to be forced into the adoption of Tory policies... The Governor [of the Bank] confirmed that that was, in fact, the case... because of the sheer compulsion of the economic dictation of those who exercised decisive economic power... I recognised the force of his arguments."[8]

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On the other hand, legal independence gives a bank only limited power to stand against broader forces in bourgeois politics. Germany's Bundesbank, famous for its independence and political clout, was able to defy its government and block a bail-out for the pound in 1992, but it was unable to prevent speedy reunification with East Germany or the conversion of old East German marks one-to-one into Deutschmarks.

The new legal independence of the Bank of England is more a symbol and a symptom of how capitalism operates today than a causative factor with its own weight. Yet is it an important symbol, which tells us much about the nature of the New Labour government.

According to Gordon Brown, the reshaped governing body of the Bank "will be representative of the whole of the United Kingdom". By this he means only that new members "will be drawn widely from industry, commerce and finance", that is, from diverse layers of the capitalist class. Nobody will elect them. Nobody outside a tiny circle of the Labour Party leadership was even consulted — at the election, or through Labour Party channels — about handing over economic powers to the Bank.

When matters get serious — and, under capitalism, nothing is more serious than big money — capitalism cannot afford democracy! So say the bankers, and so says Brown too.

VI

IN the fundamental theory of orthodox ("neo-classical") economics, the interest rate is a pivotal variable, but one set by inescapable laws of human nature. It is human nature that $100 now is worth more to us than $100 in a year's time. It is worth $105 in a year's time, or $110, or whatever, depending on our average level of impatience.

Trying to pursue this theory consistently, the eminent orthodox economist (and critic of Marx) Eugen von Bohm-Bawerk concluded that: "The cultural level of a nation is mirrored by its rate of interest: the higher are a people's intelligence and moral strength, the lower will be the rate of interest"[9].

This was logical — low interest rates should indicate a collective ability to see beyond the impulses of the moment — and even seemed to reflect facts. At the turn of the century, when Bohm-Bawerk wrote, interest rates had mostly been edging downwards for decades[10].

The orthodox theory makes superficial sense in another way. For each individual capitalist — or for the worker seeking a loan, or with some small savings — the interest rate appears as a uniform, definite, published quantity, evidently fixed by general forces way outside their control. Rates of profit, on the contrary, vary a lot from enterprise to enterprise, and depend on the skill and luck of the individual capitalist. In orthodox theory, pure industrial profit, over and above interest on capital, is an erratic product of temporary imbalances, and would not exist at all if an economy settled down into equilibrium.

It is little wonder, however, that this section of orthodox economic theory appears only in academic lectures, and is left aside when the economists study actual interest-rate movements. If orthodox theory and Bohm-Bawerk are right, then capitalist society has been in great decline, moral and cultural, for the last half-century. And in fact the credibility of the orthodox theory is only superficial.

None of us wants to eat all our week's dinners on Monday and then starve for six days, nor to live in extravagant luxury when young then poverty in later life. "Time preference" (for resources now rather than next year) is no law of human nature: rather, it is a product of the capitalist social relations which mean that the person with $10 million today can pocket the proceeds of labour and have $12 million or $15 million next year[11].

Marx's analysis turns upside-down the orthodox view of profit as an erratic addition, and interest as fundamental. According to Marx, interest is only a portion of the total surplus value generated by exploiting labour. A large enough stock of money, used to employ labour for a period, yields extra money (surplus value). The industrial capitalist pays a portion of that surplus value to the money-owner who lends him the money for that period.

The rate of surplus-value is determined by fundamentals of the relation between the capitalist class and the working class, expressed in the rate of exploitation. But "there is no law of division [between interest and industrial profit] except that enforced by competition... no such thing as a 'natural' rate of interest exists... The determination is accidental, purely empirical", wrote Marx. Or, as a modern Marxist writer puts it: "... the relationship of forces between debtor and creditor... determines how large that portion [of interest] should be... The level of interest is a question of conjuncture, being influenced particularly by monetary policy"[12].

Thus the interest rate moves up and down, within the limits of total surplus value, depending on the general balance of forces within the wealthy classes, government policies, and the business cycle. Interest rates are high, for example, at the best of a boom, when industrialists will pay heavily to expand their profit-making faster, and at the worst of a slump, when the industrialists' credit has collapsed and they need hard cash to survive.

The factual evidence heavily favours Marx's view.

VII

WHAT does Marx's theory tell us about the economic and social significance of the high interest rates of the era since 1979? It suggests, first, that the rates reflect an increase in the weight of finance-capital relative to industrial capital (though the terms of division of surplus-value must have shifted back a bit in recent years, as profits have risen and interest rates moderated). Anyone watching British TV news, and used to seeing its cameras go to a City dealing room every time they want authoritative comment on economics, must agree.

It would be wrong, however, to conclude, simplistically, that labour can or should ally with industrial capital against finance capital to restore the old not-so-bad conditions.

Banks are different from bakeries or brick factories. Yet there is a large "grey area" where finance capital and industrial capital overlap. The idea developed by Rudolf Hilferding in his pioneering Marxist analysis of Finance Capital, of the "fusion" of finance capital and industrial capital, remains valid.

An increased role for finance capital does not mean that more of a fixed pool of capital is diverted to speculation rather than production[13]. When shares are issued or money is lent, capital seems to double itself. The company issuing the shares, for example, still has a capital of $1 million, but its shareholders have $1 million capital too. If its prospects improve and the share prices double, the shareholders' nominal wealth increases to $2 million. The lender of $1 million is still a millionaire, while the borrower has his new machine worth $1 million. "All capital seems to double itself, or sometimes treble itself..."[14]

An increase in the superstructure of what Marx called "fictitious capital" does not mean that resources have been drained from a fixed pool of capital otherwise available for industrial production. In fact, more speculation may mean better conditions for industrial enterprises to grow (though it need not, and, conversely, a stock market crash does not necessarily bring a real destruction of wealth or a recession: witness 1987)[15].

The boom in money-juggling does, of course, turn a sizeable chunk of revenue to buying houses, holidays, cars, air tickets, dinners and luxury offices for bankers, money-traders, stockbrokers, lawyers and the like. It means that many of the best-educated and most energetic of upper and middle-class youth use their talents on nothing better than respectable high-tech gambling. And financial crashes can and do destroy jobs, communities and lives. All this is obscene, but not the same as a crude idea of capital being siphoned off into speculation.

Secondly: the financial markets are not the superhuman forces described by orthodox journalism and politics ("you can't buck the market"). They are a set of interactions between a few tens of thousands of human beings pursuing very particular aims, those of maximum gain for themselves or their employers. No more. Humans made them, humans can un-make them.

Yet the financial markets are impersonal to a degree. We are not in the position Rudolf Hilferding saw (with only some exaggeration) before World War 1, where six big Berlin banks controlled the German economy; nor even in that described by Harold Wilson in the 1960s, of the rule of a few "gnomes of Zurich". Finance capital today is more miscellaneous. The banks have lost ground relative to other financial operators — pension funds, for example — and none of them has the same dominant role that several big industrial corporations have in their own sectors.

Those big industrial corporations are big financial operators in their own right. They may even draw almost as much profit from juggling in the stock and foreign-exchange markets as from selling products. They are not juniors. For example, when Rupert Murdoch's News Corporation nearly went bust in 1990-1, its $2.3 billion of short-term debt was found to be spread round 146 financial institutions in ten currencies. News Corporation did have to sell or close newspapers on the banks' instructions, but outside that immediate crisis plainly no bank was in a position to control its ventures[16].

Finally, as Marx wrote, "interest is a relationship between two capitalists, not between capitalist and labourer"[17]. Whatever the clashes between those capitalists, they are at one against the workers. Both banker and industrial boss are organic parts of the same class. In Marx's day many socialists, like Pierre-Joseph Proudhon for example, thought that the evils of capitalism could be fixed up, and fair exchange of the products of labour organised, by abolishing interest. Marx criticised their view scathingly and at length: they were going for one of the organic symptoms of capitalism, rather than its root causes.

There is no selective amputation of financial power that can reduce capitalism from today's era of free-flowing international finance, high unemployment, welfare cuts, and chopped-down democracy, back to the old relative tranquillity of the 1950s and '60s. We must take our enemy as we find it, and the way to fight it is, as always, the class struggle.

Footnotes

1 Sidney Homer, *A History of Interest Rates*, Rutgers UP, New Brunswick NJ 1977, pp. 207, 378, 410, 429. I oversimplify drastically. At any time there are many interest rates, depending on who is lending to whom for how long; and, for example, short-term interest rates and long-term interest rates do not always move in parallel.

2 OECD, *International Capital Market Statistics 1950-1995*, OECD, Paris 1996.

3 Marjorie Deane and Robert Pringle, *The Central Banks*, Hamish Hamilton, London 1994, p.189.

4 Alain Lipietz, *The Enchanted World: Inflation, Credit and the World Crisis*, Verso, London 1985, p.97.

5 Karl Marx, *Capital* Volume 3, Progress, Moscow 1959, p.572.

6 *Capital* Volume 3, chapter 34 and elsewhere.

7 *ibid*, p.516.

8 Harold Wilson, *The Labour Government 1964-70*, p.37.

9 Quoted in Homer, *op.cit.* p.3-4.

10 Marx, too, saw interest rates generally drifting downwards, though he observed this as an empirical fact rather than a great historical law: *Capital* volume 3, p.359, 361. Rudolf Hilferding, in his book *Finance Capital* (p.264, 476), reckoned that interest rates stayed steady, thus increasing the banks' share of surplus value as the overall gross rate of profit tended downwards: in fact, German interest rates were pretty steady around 4.5% from about 1819 to the First World War.

11 Lending at interest to consumers, rather than producers (usury), existed long before capitalism; and probably a workers' government developing socialism, but still using money, would still use interest on loans. To recognise these facts is very different from believing in "time preference" — or "reward of abstinence", or "reward of waiting", as it has also been called — as the basic cause, rooted in human nature, for property income.

12 *Capital* volume 3 p.356, 363. Lipietz, *op.cit.*, p.47.

13 The French Marxist group Lutte Ouvrière makes this idea of a diversion of resources into speculation rather than production the basis of its whole account of "the crisis" since the 1970s.

14 *Capital* volume 3 p.470.

15 *Ibid* p.465.

16 William Shawcross, *Rupert Murdoch: ringmaster of the information circus*, Pan, London 1993, pp.8-18, 524-538.

17 *Capital* volume 3, p.382.