

INTERVIEW: COSTAS LAPAVITSAS

Finance and the credit crisis

Costas Lapavitsas is a leading Marxist economist specialising in capitalist finance and banking, who teaches at the School of Oriental and African Studies, London. He spoke to Keith Harvey in mid-July about the course of the credit crunch and the changes it has revealed in the structure of finance capital.

The sub-prime crisis has revealed enormous instability built into the financial system. By 2006 financial assets had grown to around 350% of global GDP, compared to 1980 when it was 100% and 200% in 1990. In your opinion how destabilising is this gap?

I'd like to answer on two levels. First, we need to put our finger on exactly what financialisation means for the long term secular development of capitalism and for class relations and the extraction of profits in key capitalist countries. Secondly, we need to work out what it means for instability and the forms of crisis.

In the first case I would say financialisation represents a substantial transformation of the structure of contemporary capitalism. It has to do with the asymmetric response of finance and real accumulation to the social and technological changes that took place since the mid-1970s.

These have favoured finance far more than real accumulation, and as a consequence have also favoured the creation of financial profit over profit that comes from real accumulation – productive capital. The question is where does this financial profit come from, particularly since it has grown so enormously during the last three decades?

Clearly, much of it comes from the same sources it has always come from, which is the surplus value created in production through the exploitation of workers. However, I would also argue much of it comes from a direct squeezing of money out of the wages of ordinary working people.

Financial profit originates increasingly from the financial exploitation of peoples' money income, as well as established flows of value and money, new flows of surplus value created in production. Instability is related to these mechanisms of extracting these profits.

There are many aspects to this instability. At root, instability has to do with the fact that the financial system extracts these profits out of money income while money income has not been growing or not growing particularly strongly during the last three decades.

The mechanisms through which that has been done have become increasingly precarious and the underlying capacity to create these profits has not been expanding anywhere as strongly as those who make them would like them to become.

This idea of double exploitation of the worker, once in production, once as a consumer – it sounds to me like one of the aspects of Lenin's theory of imperialism set out 100 years ago – the concept of parasitism, involving the enormous expansion of speculative capital.

This is exactly the issue we have to confront as Marxists and political economists. What does it mean for the class stratification of developed capitalist societies? What does it mean for the layers who appropriate these extra values? Are we witnessing the creation of a rentier layer, parasitical rentiers who are taking advantage of all these extra profits, creating this space. We clearly have to learn from the classical Marxist debates, but we need to be aware of how things have changed and are different now.

Let us take the rentiers for example. Many people talk about the rentier coming back, that this is the capitalism we are living in. I am a bit more sceptical about this. The rentier, in most formulations, is a person who owns idle money, money available for lending. She or he has property in money and makes this money available to others. He or she lends it and gets a return through clipping the coupons – “Mr Moneybags”.

Of course, to an extent that is true. There are people of that type and there are rich people who benefit from the changes in that way. But I don't think this characterises the class changes we've seen in the last 20-30 years. I don't think there is a particularly visible section of the classical class of this type that sets the terms and dictates economic policy.

I think the rentier today, insofar as we can call him or her a rentier, the person who appropriates this financial profit, does so partly through property but mostly through the position they occupy in the financial system. If you look at the people making these incredible personal profits who are they? They are people who run hedge funds, people who run huge industrial and commercial enterprises. Both of these types pay themselves in stock options, they benefit through capital gains (which are very often not taxed) or they pay themselves huge salaries and bonuses for the services they give.

We know this is a façade. There are no services that are worth \$1bn a year, but that's how it appears. They don't pay themselves these returns for the property they own and the capital they have lent but because of tasks they have carried out in relation to the financial system or real accumulation which allow them to appropriate this value.

These people are not rentiers in the same way that we used to think of in the past. More probably rents accrue to other layers as well, not only the hugely rich I've just mentioned. There are also significant layers of people who are basically technical adjutants of finance: lawyers, technical analysts for example. There are significant sections of people who are associated with the financial system who pay themselves enormous salaries or substantial fees

annually which, if you multiply the numbers, result in a very significant total sum of value, which doesn't accrue because of property directly but because of position and function within the financial system or mediating between production and finance.

Sure, a lot of them, once they've earned these returns, would invest them in housing and other assets, and make sure this keeps generating extra returns. But my sense is not at the moment that this is the main source of their earnings.

For Marx, moving from free competition capitalism of the 19th century into the epoch of monopoly capital, there is a shift from a capitalist's financial claim over a direct piece of property, (e.g. ownership of a particular factory) towards joint stock capital. With the latter you're talking about a general claim to a part share of total surplus value. That claim takes the form of equities, bonds etc. Surely, what you describe is adding another layer on top of that. But you're still talking of finance capital i.e. what marks imperialism out as a stage of capitalism, you're still working within that concept and not a higher form of capitalist exploitation?

It's hard to tell. We're all struggling to put our finger on developments which are new and evidently very important. We can think of a period around the turn of the 20th century as the first part of financialisation, where joint stock capital predominated, big business took over small capital, big banks took over small banks and big business and big banks started relating to each other and generating returns for each other in ways that were unseen in the middle of the 19th century.

In a sense what we are witnessing now is a second bout of financialisation but this second bout is not a repetition of the first bout. It's not what happened 100 years ago, only more so. The rentier today extracts revenue as well from the incomes of ordinary people, not simply from the incomes from surplus value created in production. The

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rentier today can command or relate to sums mobilised from the savings of ordinary people on an unprecedented scale. This did not happen 100 years ago.

The pension funds, insurance companies, money trusts, investment funds, the so-called institutional investors, basically command the idle monies that the whole of society generates. The rentier relates to that, not by lending it, because it's not the rentier's to lend but by managing it and earns income from fees associated with that and squeezes ordinary people who, on average, make very little out of this money that they make available for their pensions. Often they get defrauded out of it.

It's a new phenomenon, certainly on the scale that we're observing them. If you look at the liabilities of ordinary people, not their assets, you can see a growth of individual indebtedness which is unprecedented. People borrow to buy houses, consume, to send their children to school. People borrow to meet future needs. Many of these things used to be met in different ways. Now it becomes the

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rentier's enlarged field for extracting fees for managing these flows.

Clearly these "new rentiers" such as hedge funds are destabilising, but how essential are they to the process of production and circulation of capital in spreading risk through the system? Can they be reigned in and curtailed without major dislocation?

The first part of the question is not necessarily exclusive of the second. What we're witnessing I think, is a necessary outgrowth of the developments of the last 30 years. In that sense it is essential. It follows from all the changes that have taken place in the institutions and regulations. Can it be changed? Yes. It can be controlled, regulated far more easily than productive capital can be placed under regulatory pressure by the state or other authorities. It can be regulated because finance is a peculiar capitalist activity. It's not connected to production, it's not bound by technology, real wages, turnover in the same material way that productive capital is and therefore admits of regulation and influence much more readily than other forms of capital. Yes it can be changed. We know this. If we look back at the history of capitalism, we will see the financial capital has gone through periods of tremendous growth and expansion which frequently ended up in disaster; then it was reigned in through regulation and legal change. That option is always available to the capitalist class.

But it is part of the credit system and capitalism cannot function without a generalised credit system, certainly the proponents of capitalism and financialisation point to the virtues of the system which is spreading risk and making a larger pool of capital available for expansion. That's the historic role the credit system plays in capitalism. Is there a cut off point? A point where it can be reigned into?

Financialisation is a tremendous explosion of finance but it is not the result of meeting the greater circulation needs of productive capital. Of course, the credit system is necessary in any developed capitalist economy to deliver precisely these services that have to do with turnover of capital, accelerating productivity, the profitability of

capital and making sure that capital is efficiently used among different sectors of the economy.

But what we witnessed over the last two or three decades is not that. It's a growth far beyond that which has to do with generating profits and returns in ways that are not directly associated with this. If you look at what productive capital has been doing the picture is very interesting. You will see it is more strongly implicated in the circuits of finance than before, both on the asset side and on the liability side.

It borrows heavily and it holds financial assets heavily. It's become financialised in that way. It engages in financial activities and transactions itself. If you balance it all out you will see that as far as net reliance is concerned productive capital can do very well, industrial capital can rely on retained profits or if it needs external funds, which it still does, it produces its own paper which it pushes in the open markets.

The open markets have become huge and you get these cheaply and efficiently; it doesn't need the banks. I don't see any mechanisms or pressures at the moment that will make this change in the near future. These circulation needs of capital you pointed out appear to be reasonably well met at present. It's the other things that have come on top of that that have created the current, unbelievable situation. These have to do with the choices the financial institutions made as a result of the more limited opportunities they had to lend to productive capital. They decided to turn towards personal debt, to and open markets where they can make profits out of mediating transactions. They began to operate as brokers and speculators to a large extent.

I want to turn to the credit crunch. Do you think the scale of the credit crunch could overwhelm the resources the Federal Reserve and other central banks can call upon to deal with it?

The crisis in the US is very serious. There was a time during this last year in which people have tried to say the worst is over and its been dealt with. Its now clear with the events of Fanny Mae in July and Indie Mac this company that went bust in the US, that things are not getting better. Things are very serious primarily because banks are holding in their hands vast amounts of worthless assets. Its very hard to put your finger on how big the sum is, but its in the trillions of dollars; if you marketed them openly today their value would be pretty close to zero.

The problem starts from that. As a result of this banks are reluctant to lend to each other and they cannot obtain funds easily to continue with their other business. The problem will not be resolved until and unless the banks manage to shift these problematic securities off their balance sheets.

Have they stopped growing? No. I don't think they have stopped growing because the housing market continues to produce more of them. Even the total size of the problem assets they hold is not final yet.

It will continue to grow I suspect into 2009 because sub-prime mortgages which are the root of the problem typically extend to two to three years. The last period of extending these was 2006, so the end of 2008 or begin-

ning of 2009 is when the last batch of toxic assets will be revealed.

On top of that the problem is spreading into other non sub-prime mortgages and it appears the problem is increasingly spreading into other non-housing securitised debt – auto loans for example. The suggestion is that car loans are worse than housing loans. These large car companies extended car loans with no collateral, no examination of the borrower's credit worthiness. Nothing. The fault appears to be growing there to.

Leveraged buy out loans are also beginning to look very bad. These are huge loans extended to private equity firms and others to finance takeovers.

The housing market will continue to create bad debt for at least another six months, possibly another year, and other parts of the financial sector are also creating bad debt and all that is on the books of banks. These trillions of dollars have to be shifted off the balance sheets. How will that be done?

One thing is sure, the Federal Reserve cannot acquire all these bad debts because it will go bust itself or make its own balance sheet very weak and any ruling class would not be able to contemplate that because its central bank, is the institution that produces its money, the ultimate legal tender means of payment.

So the Fed can intervene, it can lend, as it has just recently leant enormous amounts of money, opened the line of credit to Fanny Mae (i.e. mortgage association). It can do that but it cannot acquire all the bad debts. That's just not possible. The HBIC, which is the other regularity authority in the US also has significant reserves, and it can also intervene and deal with some of these problem debts as they arise but the collapse of Indie Mac last week took away 10% of its reserve. And Indie Mac wasn't particularly large.

Can the banks obtain fresh capital in the open market to make good these losses as they write off these problematic debts? Can they replenish their capital from the open market and find a market solution? Not possible at all. This is the least possible of them all. We've seen during the last few months, apart from everything else the stock market is collapsing, they have fallen dramatically so banks have enormous difficulty obtaining fresh funds. That will continue to be the case for the foreseeable future. It's just not possible to get the sums from the open market.

What prevents the sovereign wealth funds with their \$12-15 trillion of reserves, recycling their petrodollars and huge savings to recapitalise these institutions?

Capital losses. Those who bought US stocks in December 2007 have lost a lot of money considering what shares have done. It is possible for sovereign wealth funds and other non-US holders of capital to intervene and acquire parts of the US financial system and we will probably see some of that. That will be judiciously done and done as and when it suits these buyers.

This is not going to be a lever to rescue the US financial system en masse. Those who hold the money are not prepared to contemplate it. That's not their job. That's not what they are out to do. That is not really a viable solution.

Where does that leave them? The only final option is central government which has two levers, the first directly, the second indirectly.

The first is tax revenue. My suspicion is this is what they will be forced to do. The Japanese monetary authorities who have been through a disaster on this scale, in the 1990s, were among the first to say you will need public funds to deal with this. They said that because they knew the extent of the problem they faced.

Obviously, if the US government decides to mobilise hundreds of billions or trillions of dollars out of tax revenue to rescue the banks they will have to confront the political fall out. There will be a lot of people in the US opposed to such a course of action, home owners who have lost their homes, others who are close to losing their homes and also people who have some sense of how public money should be used. That opposition will not be easy to deal with politically. It's not an easy thing for them to do. I think increasingly this is the way it's going though.

The second option they have is not directly in their hands: to print money. That is a very dangerous option for any ruling class. I don't think this is what they will do.

This solution suggests that on top of the double exploitation the worker suffers there will be a third layer. First as worker, second as consumer, third as taxpayer?

Exactly right. At the end of the day if they rescue the situation and unless there is political opposition they will do so on the backs of working people. Not only will working people have provided the profits in the boom, they will also provide through being squeezed from tax the money necessary to rescue those thoughtless and speculating financiers.

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The Financial Times recently suggested that the assets of the mortgage companies are very good quality relative to the toxic loans of the sub primes and having opened up the credit lines to them they stabilised the debt situation. Also only seven regional banks have gone bust so far. It's nothing compared to the danger of the savings and loans crisis of the late 1980s?

Every time there is a bout of intervention you get all these articles and people saying "that's it". Then it turns out that this wasn't quite "it". I don't know if it's going to be "it" or not this time. I would take what the commentators say with a large pinch of salt. At the turn of the year the Fed thought people were not buying mortgage backed securities. They needed someone to start buying

them so the market can keep going. Yes Fannie May can do that, they said, and encouraged them to buy. But coming on top of an already weak balance sheet it nearly finished them off.

As for other banks . . . it depend son how you see it. Some of the stuff I see even mentions two thirds of such enterprises being effectively bankrupt. The worst, alarmist scenarios that one sees being bandied about mentioned

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that half the US banking system might disappear. I'm not saying this is going to happen.

Looking at the debate in the financial press about regulation in the future, if the crisis is retained within certain manageable limits, there will be calls for banning or restricting types of products for sale, capital adequacy ratios of the banks being increased, new regulatory bodies with more powers, ratings agencies being more rigorous etc. do you think there is any real likelihood of a significant increase in the central core regulation of the financial services?

Not at the moment. I see no real evidence that the significant section of the ruling class, people with power and theoretical and ideological understanding of what needs doing are planning to bring significant changes about. Most of the discussion that one sees about changes and regulatory rearrangement are much in line with what we've witnessed many times before. I would say there's a game being played here.

The financial sector which has very good placement in policy-making and power circles of Washington has learned how to play this game very well. They're masters at it. Their own people sit right at the top of the US government. By now we've seen the game many times. As soon as a crisis arrives they know they will need money and some kind of public credit or public money and they start playing a game that says yes, we've done things to excess but we've learned our lesson.

Yes, we need some regulation but this regulation must be brought about in consultation with us and yes, we would accept and tolerate some external impositions on us but by and large we would like to create our own regulation from within because that is the best way to ensure the efficiency, competitiveness and all the other great things we produce in the economy. If you shackle us we're going to lose our ability to innovate and all these marvellous things we've done for the economy in the last 30 years will be lost.

They have tried this a number of times in the last two decades and every time they have won. All the signs I see are that they are playing exactly the same game again. I

don't see any serious opposition from within the ruling class to that. How do we interpret this? On the one hand it shows that even if they deal with the problem right now they are only sowing the seeds of another crisis further down the line. These people have created a crisis every four to five years.

The other thing it shows more profoundly is something seems to have gone deeply wrong with the ruling classes in this country and the UK too because they seem to have lost their capacity to produce new ideas and new ways of dealing with economic problems even when the old ones are obviously malfunctioning from their own perspective.

This gigantic crisis has been created by private finance, not by state imposition, not by war, or unions demanding high wages. They've done it themselves. Yet it is quite remarkable how in the midst of this all the talk you hear is about defending the market, protecting competition, giving people incentive to innovate.

They haven't got any decent new ideas. When they want to appear as if they're going to seriously regulate and control, what do they come up with? They're going to demand higher capital requirements; they will turn the 8% into 9%. Big deal. Is that all they can come up with in the face of this major disaster that's led to millions of people losing their homes, to bankruptcies to unemployment?

The 1907 banking crisis in the USA gave rise to the Federal Reserve. The 1929 Wall St crash gave rise to the New Deal. Is that scale of shift likely to appear in their outlook?

They're not capable of doing it. The power that finance, as it is constituted at the moment, possesses or has available to it right at the heart of government must not be underestimated. They are very influential in dictating policy. The other thing that's very important is the ideological dominance of all this neo-liberal talk of the last decades. It has worked as a kind of censorship in public debate where voices that would be prepared to say something different have been ignored and not given a tribune at all.

The third thing that's important is of course universities. Universities are not to be underestimated. A lot of these people who are in the upper echelons of finance are university trained people, not all of them economists, but the ones that make decisions are economists or trained in economics and what kind of training do they get in economics? It's the same standard market, new liberal type of stuff which doesn't give you the mental and other equipment to think of the world otherwise.

In my judgment the ruling class in the US and this country too has a problem in coming up with new ideas and new perceptions and formulations of the world that would allow you to come up with alternative policies. That is a sign of bankruptcy, intellectual bankruptcy.