[https://gegen-kapital-und-nation.org/en/surface-tension/]

Surface Tension

Historically, capitalism has been in crisis over and over again and the results of the most recent one are yet to fully unfold. A common theory on the Left and among Marxists about the current crisis and modern crises in general is as follows: the growth in financial capital has come about because productive (and commercial) capital has been in crisis since the 1970s and has proven itself incapable of capitalising sufficiently. Capital cannot be invested in productive capital and thus flees to the speculative sphere of finance to sustain itself. Eventually, the financial bubble grows so big that it becomes unsustainable and bursts: crisis.

Thus, according to this theory, fundamentally at their core all crises are production crises, because productive capital is no longer capable of sustaining financial capital. Usually, the two main points to support this theory are:

- In general, the rate of profit has the tendency to fall under capitalist accumulation (Karl Marx argued for this in volume 3 of *Capital*).
- Since the 1970s profit rates in the productive sphere have been in decline and financial capital has grown.

However, even if we accept these points to be true, they do not explain exactly how and when productive capital packs up and takes down financial capital with it. At best, we are offered the circular explanation that the most recent crisis demonstrates financial capital's unsustainability: crisis because of crisis. This text presents a few arguments on the relation between productive and financial capital (The mechanisms of financial capital's growth are summarised in *Financial Crisis 2008ff.*) and in particular argues that financial capital assesses the sustainability of productive capital and ultimately decides its fate. Furthermore it argues that the relationship between the "tendency of the rate of profit to fall" and crisis of finance capital is not as linear as claimed and that the posited opposition between investments in productive and financial capital is unfounded.

Productive capital

Productive capital is any business which makes a profit by producing commodities and selling them on the market. Every such endeavour uses its size as a means of competition. Every manager or capitalist knows that bigger investments yield higher profits. This is true in the simple sense that if the profit rate is 10% and a capital invests £2,000 instead of £1,000 it will make £200 instead of £100. However, the relation between investment and profit also holds in a second sense: technical advances, better machines, improved factories, more efficient work flows and novel techniques are all available, for a price, in a market economy. Because money is the ultimate social power, because everything is available for purchase, because money is control over land, people and technology, higher productivity is only a question of price. This increased productivity can be and is used by competing enterprises to conquer new market share, to squeeze out the competition and to make an extra profit. This extra profit is due to the fact that increased productivity usually translates into reduced unit prices. Thus, the more productive capital can either undercut its competition and capture market share or make an extra profit by selling for the normal price. However, this advantage does not last forever, since productivity is available to

anyone with sufficient cash - including the competition. It either catches up or perishes. Those who manage to catch up will undercut the leading capital in order to capture (back) market share; the extra profit is gone. On the other hand the average unit price will be likely to drop because the market will only absorb so many commodities of a certain kind. Also, this process often involves cutting workers loose and ruining other capitals; both of which limit purchasing power in general.

As a simple example, consider a car manufacturer who invests £10 billion in a new factory; this will involve big machines capable of producing, say, hundreds of cars per day. If this investment works and he captures a significant market share he might even be able to sell all of those cars. However, if the competition catches up quickly - and also invests billions in a new factory - this does not mean that the market will absorb twice as many cars as before. If these new factories also reduce the 'cost factor' labour by making it redundant, both manufacturers deprive some of their potential customers of their source of revenue. Big investments were made, production capacities accumulated but neither company can sell its cars for the anticipated price (if at all): over-production beyond what the market can absorb in combination with massive investments.

This kind of over-production is not the result of wrong management decisions; rather it is the systematic result of competition between private producers. Every company expects competing enterprises to catch up or even to take the lead. Thus, every enterprise is permanently chasing greater productivity, which usually comes at the price of a bigger investment in machinery or research and development (Volume 1 of *Capital* goes to great lengths to explain this process. While some argue that Marx's assertion that the price paid for big machinery must grow relative to the price paid for labour is wrong, this debate does not concern us here. We simply accept the empirical fact that this process often implies bigger investments.).

The paradoxical result of this process is that in the chase for extra profit, capital creates a situation in which bigger investments are needed to survive in a market which has not significantly increased. Thereby it undermines its own profitability (On a quite superficial level, this describes the 'tendency of the rate of profit to fall' discussed in volume 3 of *Capital*).

While this illustrates the insanity of the capitalist mode of production in which too much stuff is produced and goes to waste while the majority of people are deprived of the means of reproduction this does not yet imply the sphere of financial capital.

To avoid a potential source of misunderstanding: the insanity and brutality of the capitalist mode of production are reason enough to abolish it. Thus, when, in the following sections, the effects of financial capital on the productive sphere are discussed this does not imply any partisanship for the latter.

Loan capital

Another kind of business is banking (this section does not deal with the financial sector as a whole but only those departments which directly deal with productive capital in the form of loan capital). Its most basic form is to lend money for a price, i.e. credit. First of all, credit is nothing but a legal claim on an augmentation of advanced money. That this augmentation will happen is assumed when credit is granted. Credit is blind to how this augmentation is accomplished, it just demands that it is successful and that once performed interest will be paid. Credit also presupposes that the possession of money is a sufficient condition for making more money; credit presupposes that all the things required to start a thriving business - land, technology, people - can be purchased on the market.

Credit appeals to productive business for quite a few reasons. Using credit, industrial capital is liberated from the boundaries of its own profit. In this context the most basic form of credit is the bill of exchange (These days, bills of exchange do not seem to be that common anymore. However, their basic form allows to explain loan capital clearly). Say a productive capitalist produces goods worth £100. The next step is to sell those goods in order to re-invest (part of) the return. This sale costs time and money (e.g. for storage). One way around this is to accept a bill of exchange from a commercial capitalist who promises to pay £100 once he has sold off all the commodities. The first capitalist can now take this bill of exchange to a bank and receive £100 minus bank charges. She can thus commence production again without having to wait for the realisation of her profits. Overall, this makes the amount of money productive capital needs up front smaller, since the period between purchase and sale is shortened (This is described in detail in volume 2 of *Capital*}.

More advanced forms of credit do not involve bills of exchange; instead they are direct credit from banks, for instance in order to extend production with funds which are yet to be earned (through extended production). As described above, productivity, and thus the size of one's capital, is a means of competition. Just because the market is divided and saturated does not imply that the enterprises engaged in this market can relax, on the contrary: they have to undertake bigger investments in order to capture more market share. The availability of credit adds new momentum to this competition.

Effects of loan capital on the productive sector

The availability of credit heats up the competition because now money is available in new dimensions: expansion is not limited by the funds of the players in the field but by how much money the banks are willing to throw at it, based on how profitable they deem the sector to be (The banks command a vast amount of money because they command all the money in society; hardly any commercial transaction happens without a bank being involved. This way, the banks turn all money in society into capital. Their role also allows them to lend out more money than they have in their vaults. For details, see our text *Financial Crisis 2008ff*).

Being credit-worthy becomes a major means of competition. The simple fact that this device is available to the competition implies that a company has to consider credit in order to succeed.

Consequently, the service offered by the financial industry to the productive sphere has a long-lasting effect on this sphere. On the one hand, companies become independent of their own productivity by having access to funds which they have yet to earn. On the other hand, they *have* to make use of credit in order to succeed, even if business is in the black without it. Thus, the financial industry's role changes from that of a service provider to that of the executioner deciding a company's fate. Now, companies not only compete for a greater market share and higher productivity in order to make bigger profits, but they also do this to impress their bank so that it will grant further credit, allowing the next big investment to be made ahead of the competition.

This also implies that there are no hard criteria determining how well or badly a particular company or branch must be doing in order for it to survive and succeed. While the banks certainly base their assessment on current economic data, ultimately it is their decision, since, at the end of the day, they are trying to predict the future. If a company is struggling they can either grant more credit hoping this will push the company over into profitability or they can pull the

plug. If money is the sufficient condition to make more money (the very basis of the loan business), then a bigger credit facility might be the sufficient condition to make a struggling company profitable again. Since every competing company has similar negotiations, the success of this venture is quite uncertain. On the other hand, it is definite that withdrawal would mean loss of all the investments made so far.

An example of this process is the dotcom boom and the crash of 2000. Venture capitalists invested massive amounts of money into the web industry, hoping that eventually these investments would be met by above-average returns. The fact that hardly any of the companies they invested in made any profit did not immediately concern them. Instead, there was hope that although this new technology was not yet profitable it would turn around eventually. In 2000, some internet companies did indeed start to earn money, however only with profit rates comparable to other medium sized business. This showed that the estimates of above-average gains were unfounded and investors fled the market in pursuit of better business opportunities and the dotcom market crashed.

As long as new credit is provided to maintain and extend production, and to pay off old credit, a company's debt is an investment and asset held by the bank which ensures participation in future profits. Loan maturity is not a problem as long as new credit is available to satisfy it. And vice-versa the other way around. In case of withdrawal, debt accumulated by a company becomes an unproductive liability, i.e. toxic. When in 2008/2009 the financial industry was unable to provide new credit to the auto industry, all its extended production facilities and finished products - maintained in pursuit of future purchasing power and market share - became worthless pieces of junk.

After all, it is obvious that just because there are many people who would happily drive those cars this does not change a thing about the fact that they are abundant, just like there is an abundance of everything in crisis: an abundance of factories, workers, products, an abundance of capital. So much for the efficient use of resources in the most humane of all societies.

Growth

This does not yet explain bigger growth rates of financial capital compared to its productive counterpart. As pointed out in the introduction, some authors claim that this is at least partly due to investors avoiding big investments in the productive sphere in favour of financial products, i.e. the empirical data would show that productive capital is not capable of attracting investments in competition with financial capital.

However this asserts the wrong opposition that a given amount of money is *either* invested in the "real economy" *or* in the financial sector. If for example a company pays wages using the returns from commodity sales then this money came from and arrives in the productive sphere. However, the same money visited the financial sector at least twice already. First, every company does business via bank accounts when selling commodities. Second, most wages end up in a bank account for some time. Because a bank can usually estimate for how long a certain amount of money stays in an account - managing other people's money is its business - it can work with that money in the meantime. Even more so if it manages several business and private current accounts and is able to arrange those in a way to ensure the availability of funds for its endeavours.

An organised banking business attracts all money in society and thus there is hardly any money from the productive or commercial sphere which does not contribute to the financial sphere.

Still, once a bank or some other financial institution received a certain amount of money they are presented with the problem where to invest it; in the "real economy" or in some financial products. Here, too, ultimately the opposition is unfounded. If a bank invests in a company producing commodities it invests in the "real economy". If this company buys machines using this newly available capital, another company, selling machines, receives payment which eventually arrives in some bank account. Maybe even with the same bank which credited the first company. The bank will now use these funds for further investments. If, on the other hand, this money is invested in a hedge fund then this investment is made directly in the financial sector. However, an investment in an equity fund might also end up in the productive sphere eventually.

Furthermore, growth - both in the "real economy" and of financial capital - is not limited by available money quantities. As described above the purpose and effect of the loaning business is to make companies independent from the profits they already realised. Beyond that, the banking industry can use credit and the fact that it attracts all money in society to become relatively independent of their own and all money reserves.

However, it is correct that in the last couple of years assets in the financial sphere grew faster than in other sectors. This was not always the case and is not uniform across the globe. For instance, the service and finance sector only started its boom in Germany in the late '80s after a series of legal changes.

Substantially very different types of assets grow: A company producing commodities principally assesses its growth as follows: it estimates its fixed capital (machines, factories, etc. which are part of the production process for a longer time) and amortises it over time. Also the average price which regularly has to be paid for wages and raw materials is added. Then a company determines how much money was made through the sale of commodities.

If money was borrowed this has to be subtracted just like outstanding interest payments. This way the company arrives at a conclusion how much it is worth - did capital sustain itself - and by what rate it grew - did capital realise itself. Hard cash is always just a passing item, most of the capital is in the form of machines and commodities to be sold.

A financial institute grows differently: it borrows money and invests it. The money in its vaults is a relatively small item in its business. A bank is not interested in hoarding cash. From the point of view of the banking business, available funds are an imaginary deduction from profit since this money could be activated to earn an interest. Cash is only a necessary evil for a financial institute when it is used to pay back debt or to satisfy interest.

What grows in the financial sector are not primarily increased gains through earned interest but claims on future wealth; debt is treated like an asset, like value. For instance a bank B treats a bond from a company C to a bank A as a security and consequently the money invested in the company C is counted twice: once as proper money in the hands of the company and once in the form of a promise on future payment - the bond in the hand of the bank.

One bank on its own cannot do that. But a developed financial sector can principally turn a limited quantity of money into an unlimited number of debt relations. It can also provide the basis for treating them as assets through the permanent purchase and sale of these claims. This allows the financial sector to grow rapidly and sometimes even more in particular areas of the market such as during the dotcom and sub-prime mortgage booms.

This text by the "Wine and Cheese Appreciation of Greater London" first appeared in kittens #0.