



On the Content of Banking in Contemporary Capitalism

Paulo L. dos Santos

Department of Economics

School of Oriental and African Studies, London

ps45@soas.ac.uk

Abstract¹

This paper considers the character and social content of banking in contemporary capitalism. Based on a survey of the operations of nine leading international banks, it documents the marked differences between contemporary banking and the traditional business of taking, making loans to enterprises, and making profits from the difference in interest-rates between them. Notably, the operations of the world's top banking organisations are shown to centre on various forms of credit to individual wage-earners and on mediating access to financial markets by corporations and, increasingly, individuals. In order to characterise the social content of such activities, the paper seeks to apply, and where necessary extend, existing Marxist analyses of banking, capital-markets, and their relationship to capitalist accumulation. This includes advancing a number of elements of a distinctive Marxist interpretation of capital-market operations to theorise financial-market mediation-relations between banks, corporations, and the mass of retail-savers. The analysis pursued helps identify the distinctive and exploitative content of the relations banks maintain with ordinary wage-earners through consumer- and mortgage-lending, as well as through the provision of pension-related saving services.

Keywords

Marxian economics, banks, investment-banking, pension-funds

Introduction

By many historical measures, the current financial crisis is without precedent. It originated from neither an industrial crisis nor an equity-market crash. It was precipitated by the simple fact that increasing numbers of largely black,

1. I would like to thank the participants of the International Workshop on the Political Economy of Financialisation at Kadir Has University in Istanbul, and the participants of the Crisis of Financialisation Conference at SOAS in 2008. A special acknowledgement is owed to Professor Makoto Itoh for his detailed and prescient comments on an earlier draft. All remaining errors and one-sidedness are my own.

Latino and working-class white families in the US have been defaulting on their mortgages. That this caused Bear Sterns and Lehman Brothers to collapse, bringing the entire financial system to the brink, and continues to generate losses for banking giants like Citibank and UBS, underscores the fundamental changes to the practices, class- and social content of banking that have taken place over the past twenty-five years.

Banking has become heavily dependent on lending to individuals, and the direct extraction of revenues from ordinary wage-earners. It has also become enmeshed with capital-markets, where banks mediate financial-market transactions involving bonds, equity, and derivative-assets, and where they increasingly obtain funding. And it increasingly relies on inference-based techniques for the estimation of risk of capital-market instruments and banks' own financial position. The current financial crisis is, in many ways, a crisis of banking as it has emerged through these dramatic changes. Identifying the origins, content and contradictions of contemporary banking is, consequently, an important part of understanding the current crisis, as well as the broader character of contemporary capitalism.

Contemporary banking is very different from the traditional business of taking deposits from corporations and the general public, making loans to enterprises, and making profits from the difference in interest rates between them. It is also different from the 'finance-capital' described within the Marxist tradition by Hilferding in 1910. Nevertheless, Marxist political economy has a unique and important contribution to make to the analysis of the social and historical significance of contemporary banking and its relationship to accumulation. This paper seeks to make empirical and analytical contributions to this task.

Empirically, it considers macro-level data, centrally from the US, on banking and capital-markets. It also considers in detail the operations of nine of the largest international commercial banks, based on their annual corporate disclosures.² These are leading US, European and Japanese banks which, by the end of 2007 collectively controlled more than US\$16 trillion in assets across every region of the globe. Even in 2007, when most of them took

2. The banks examined are Citigroup, HSBC, Bank of America, RBS, Barclays, Santander, BNP Paribas, Dresdner Bank, and Sumitomo Mitsui Financial Group. The first two banks have the most prominent and extensive international operations. The list includes the top two US and top three British commercial banks. Santander is the top bank from Spain, with extensive international operations, notably in Latin America. Dresdner bank was chosen over Deutsche as a representative German bank as the latter is principally an investment-bank. BNP Paribas and SMFG are leading French and Japanese banks. See appendix for details on extraction of data from corporate reports.

considerable losses, their average return on equity was still a relatively high 14.87 per cent.

Firm-level inquiry reveals how central lending to individuals has become for the world's largest banking organisations. It also reveals the relative importance of different financial-market mediation-activities, each of which embodies different social relations. Notably, revenues from fund-management and profits on trading and proprietary accounts appear as important sources of bank-profits, particularly for European banks.

In order to characterise these activities, the paper advances a series of analytical elements pertaining to the different major functions of contemporary banking, drawing on Marx, Itoh and Lapavistas, and most directly from Hilferding.³ Particular attention is given to the characterisation of financial-market mediation-functions. This includes advancing a distinctive appreciation of the social content of capital-markets and investment-banking, building critically on Hilferding's 1910 analysis.

On these bases, the paper argues that contemporary banking centres, on one hand, on mutually beneficial, arms-length relationships with corporations based on investment-banking services. At the same time, banks have developed historically new, *exploitative* modes of appropriation from the independently secured income of wage-earners. Those have developed in the political climate created by significant class-defeats suffered by the working-class movement, in which the provision of a growing share of necessary goods and services became or remained private.

Private provision of education, housing, and health make access to money a growing requirement for present and future consumption. Against a setting of stagnant real wages and rising income-inequality, this has pushed wage-earners onto financial markets as an integral part of their basic reproduction. Banks mediate access to housing, durable consumer-goods, education, and increasingly health-care, though insurance-, mortgage- and other individual loans, drawing profits from wage-income that are increasingly central to their operations.

The gradual privatisation of pension-provision has also helped banks develop other avenues of appropriation founded on wage-income. Pension- and other investment-funds have generated rising fee-incomes for banks. The associated unprecedented money-inflows into capital-markets have also enhanced the scope for various corporate 'financial engineering' measures in which banks play a central role. In contrast to the relationship between corporations and banks, these activities bear the mark of the profound social inequality between

3. Marx 1909, Itoh and Lapavistas 1999, Hilferding 1981.

wage-earners seeking to secure future consumption and banks seeking to maximise profits, as glaring and arguably systematic disadvantages to the former. It may be usefully understood as possessing an exploitative content.

The rest of the paper proceeds as follows. Section 2 lays out the broad changes to the composition and character of banking incomes and discusses the regulatory, technological and capital-market setting that has shaped them. Section 3 turns to the changes to conventional lending and money-dealing activities of banks. Sections 4 and 5 consider the significance and social content of financial-market mediation-functions performed by banks. Section 4 focuses on fund-management, derivative-assets and proprietary gains. Section 5 offers distinctive Marxist analytical elements for an approach to the social content of capital-markets and traditional investment-banking functions. Section 6 offers a brief concluding discussion.

2. New sources and types of bank-income

A number of studies have documented and discussed the changes in banking over the past three decades.⁴ The broad empirical contours highlighted by those studies are clear. The income banks receive from interest-rate spreads has steadily diminished in importance. Households have shifted their assets away from bank-deposits in favour of various investment-funds, and the importance of bank-lending to enterprises has fallen significantly. Banks have responded by developing new revenue-streams in fees, commissions and other non-interest gains from activities associated with 'financial-market mediation'. These involve facilitating the participation of others in financial markets through investment-banking services to corporations, brokerage and, increasingly, through the management of investment-, mutual, pension- and insurance-funds for retail-investors. Banks have also increased lending to individuals through consumption-loans and mortgages.

These trends are evident in macro-level data for advanced economies.⁵ Bank non-interest income has increased in significance throughout the OECD countries.

4. See Allen and Santomero 1997, 2001, Erturk and Solari 2007, Leyshon and Thrift 1999, Lapavistas and dos Santos 2008, for instance.

5. The observations here also broadly apply to the other OECD economies for which comparable data is available. See <www.oecd.org>.

Table 1: Non-interest income as percentage of total bank-revenues

	1980	1985	1990	1995	2000	2005
United States	24.9	30.5	30.3	32.1	39.7	40.7
(West) Germany	20.4	20.6	26.8	21.0	35.8	34.2
Spain	14.9	15.6	18.2	23.1	35.8	33.2
France			22.6	45.5	60.9	62.2

Calculated from OECD Bank Income Statement and Balance Sheet Statistics

Bank-lending has correspondingly declined in importance. It has also changed in composition, shifting from lending to real-sector firms towards individual consumption- and mortgage-loans. In Germany, non-mortgage bank-lending to non-banks declined from 68.2 per cent of GDP in 1972 to 26.8 per cent in 2003. In Britain, resident banks' lending to individuals rose from 11.6 to 40.7 per cent of total lending between 1976 and 2006, with lending to financial intermediaries also rising from 20.3 to 32.4 per cent. In the US, bank-lending to commercial and industrial enterprises fell from 10.8 to 8.2 per cent of GDP. Although belated, the corresponding fall in Japan has been sudden, with bank lending to non-financial enterprises moving from 61 per cent of GDP at the end of 1997 to 39.2 per cent in the autumn of 2007.⁶

2.1. *The rise of the institutional investor*

A number of interrelated processes and innovations have created the context for these changes. Technical innovation has been instrumental in the orientation of banks to individual credit. Credit-scoring methods have made mass retail-lending possible by yielding quantitative (and problematic) estimates of the creditworthiness of individual borrowers, and of large, securitised pools of loans to individuals. Technological change has also created new money-dealing services, such as ATMs and ebanking, whose costs banks appear to have been passed on to retail-depositors.⁷

State-policy in favour of financial liberalisation, and secular changes in the financial behaviour of corporations and households, have been particularly important. Most directly, the relaxation and repeal of Glass-Steagall restrictions in the US, and the acceptance of the provision of various insurance-services by

6. Percentages calculated from Bank of England, US Flow of Funds, Financial Accounts for Germany, Bank of England and Bank of Japan data.

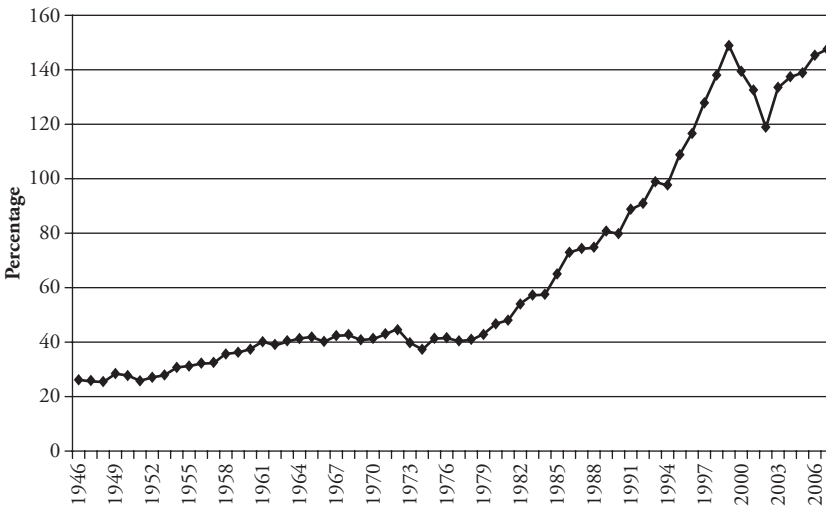
7. See Lapavitsas and dos Santos 2008.

banks in Europe have widened the scope for commercial-bank intervention into capital-markets.

More fundamentally, the rising importance of corporations' own retained earnings, and the gradual privatisation of pension-provision have had a major impact on both sides of capital-markets. On the demand side, increased volumes of money have sought to buy securities. On the supply side, the scope for capital-gains generated from various 'financial engineering' measures has increased. And, across both sides, the scope for fee and other income from financial-market mediation has been greatly enhanced.

As state-pensions have been eroded across the OECD countries, trillions of dollars entered capital-markets in the form of various retirement-related investment-funds. The late 1970s and early 1980s saw a raft of measures that both degraded public pensions and encouraged private-retirement savings in the US. Access to tax-sheltered Individual Retirement Accounts was steadily broadened in the 1970s, and 401(k) plans were implemented in the early 1980s. The 1981–3 Greenspan Commission on Social Security endorsed these measures and led the charge against the quality of public pensions by imposing income-tax on benefits over a very low level.⁸ As a result, the holdings of

Figure 1. US household holdings of pension- and mutual funds, percent of GDP (1946–2007)



Calculated from Flow of Funds of the United States

8. See Greenspan Commission 1983 and Investment Company Institute 2006, 2007.

pension- and mutual funds by US households exploded, from a postwar-average around 40 per cent of GDP to the 120–140 per cent average of the last ten years.

Japanese households also accumulated significant financial assets over the same period, including a high level of insurance-reserves, which include pension-savings.

Table 2: Japan household mutual-fund holdings and insurance-reserves, per cent of GDP

1980	1985	1990	1995	2000	2005
21.8	36.2	54.6	72.3	83.5	88.3

Calculated from OECD Data

Similarly, across a range of OECD countries, total holdings of open- and closed-end investment-funds and insurance-reserves rose from 41.9 to 73.4 per cent of GDP between 1995 and 2005.⁹ By 2006, these increases had helped take the worldwide total of assets in managed funds to a total of US\$63.8 trillion, more than twice the combined GDP of the US and EU for that year.¹⁰

The rise of these institutional funds created new ‘buy-side’ opportunities for banks. They could earn fees from directly managing investment-funds. In addition, they could earn fees by assisting independent insurance-, hedge- and other investment-funds in their securities-transactions.

2.2. *Changes in corporate financial behaviour*

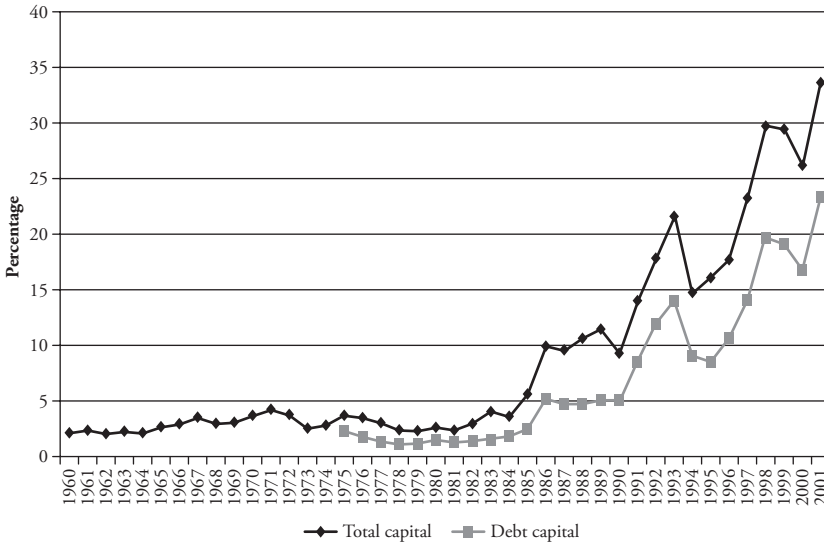
The new funds also helped create new ‘sell-side’ revenues for banks by fueling a tremendous increase in capital-market issuance, particularly in the US. The issuance of US corporate liabilities, notably bonds, grew in tandem with new money-inflows, rising from a postwar-average of around four per cent of GDP to well over 30 per cent in 2001.

Evidence for US non-financial corporations suggests this increase in the issuance of marketable corporate liabilities signalled fundamental changes in their relationship with capital-markets. Since the early 1970s, their net fixed investment has tended to fall, with cyclical fluctuations, in relation to profits. In the 25 years to the end of 1984, the net fixed investment of

9. Figures calculated from OECD data for Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Spain and the United Kingdom.

10. Watson Wyatt 2007.

Figure 2. US corporate capital raised as percentage of GDP (1960–2001)



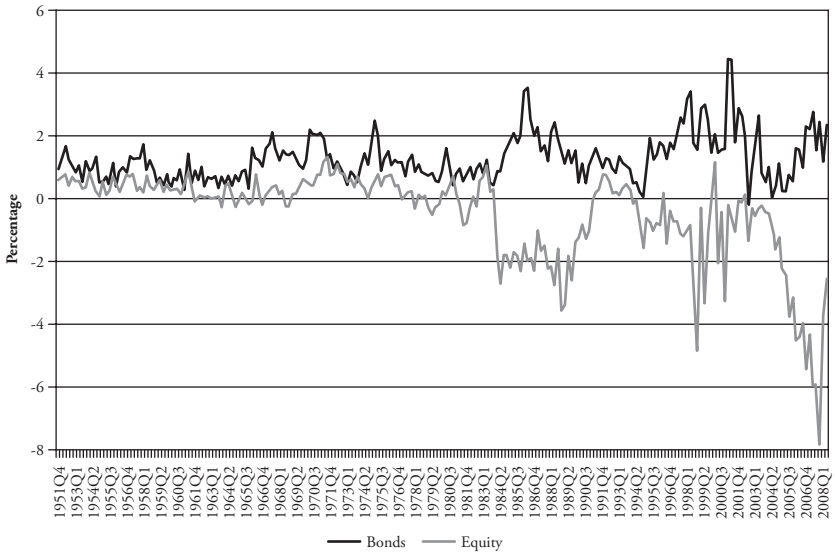
Calculated from Securities Industry Association Factbook, 2002

US non-financial corporations averaged 23.7 per cent of their actual profits. In the 25 years that followed, they averaged 17.7 per cent, despite the dot.com investment-boom of 1995 to 2000. In this context, the increase in corporate-security issuance was not associated with increased productive investment, which could increasingly be funded with internal funds.

Instead, it was associated with a dramatic increase in ‘financial engineering’ operations aimed to secure capital-gains. As bond issuance grew in importance for non-financial corporations,¹¹ its relationship with net equity-flows underwent a fundamental structural change. In pure statistical terms, bond-finance flows displayed a clear positive correlation with equity-finance flows between 1946 and 1983, suggesting they were alternative sources of funds. Since 1983, the correlation become negative, as did net equity-flows.

In words, the increased corporate bond-borrowing over this period appears to be closely related to the withdrawal of equity, which typically takes the form of ‘financial engineering’ operations like share-buybacks, private-equity purchases, mergers and acquisitions. These operations have become increasingly important to the relationship of non-financial corporations and financial markets, at least in the US. As discussed in detail below, the potential capital-gains achieved

11. Rising from 46.7 per cent of their borrowing in 1983 to 70 per cent by 2007.

Figure 3. US non-financial corporations' net finance-flows, percent of GDP (1951Q1–2008Q2)

Calculated from Flow of Funds of the United States

by such operations are greatly enhanced in a setting of increasing volumes of money entering capital-markets. Commercial banks have developed significant revenue-streams by managing, advising, underwriting and financing these financial operations.

Through all these changes, banks have been able not only to maintain, but actually to increase the significance of their profits in the advanced economies.

Table 3: Bank-profits as percentage of GDP

Country	1980	1988	2005
United States	0.72	0.74	1.62
(West) Germany	0.53	0.81	1.35
Spain	0.84	1.42	1.77
France		0.96	1.53

Calculated from OECD Bank Income Statement and Balance Sheet Statistics

3. Economic relations of bank-lending and money-dealing

Changes in banking-operations and social relations have included important changes in bank-lending and money-dealing functions. Marxist political economy has long offered compelling accounts of the nature and social content of these banking activities.¹² Those can be readily extended to offer insights into the particular forms these activities take in contemporary banking: lending to individuals, and rising banking and credit-card account fees paid by retail-bank clients.

Through both channels, banks have come to mediate increasing proportions of consumption, drawing revenue from the independently secured wage-income of their clients. As such, they constitute historically novel avenues for the financial expropriation of wage-earners. This section tackles these changes in bank-behaviour, offering an empirical and analytical discussion of the importance and distinct social content of these new channels of appropriation.

3.1. *Lending to enterprises*

Classical-Marxist analysis of bank-lending is founded on the distinctive concept of interest-bearing (or loanable) capital. Interest-bearing capital is a peculiar type of capital that is distinct from industrial and commercial capital. It originates from idle pools of money-capital that appear in the first instance over the course of the circuit of industrial and merchant-capital. Such pools are mobilised and transformed into loanable money-capital by the credit-system, which channels it back into circulation in the form of loans to capitalist enterprises.¹³ Trading in interest-bearing capital involves credit-relations, that is, the advance of value against a promise of repayment with interest. In this light, banks are capitalist enterprises that specialise in all aspects of dealing in interest-bearing capital, accruing revenues from the difference in the price paid for deposits and that paid on loans.

Loanable money-capital receives not profits but repayments with interest. To Marx,¹⁴ the level of the rate of interest contains an element of irrationality: it is the price – or expression of value in money – of a future flow of money. It also reveals no underlying socio-economic relationship or inherent material aspect of social reproduction, not least because it is not the price of a produced commodity. The rate of return on loanable money-capital is determined simply through the interaction of supply and demand. To Marx, competition between buyers and sellers, however, tends to maintain the rate of interest between zero

12. Best developed in Hilferding 1981.

13. See Itoh and Lapavistas 1999.

14. Marx 1909. See Part 5.

and the rate of profit during ordinary periods. Their relative detachment from the material realities of production makes relations defined over loanable money-capital highly susceptible to the influence of broader patterns of socio-political power.¹⁵

In lending to capitalist enterprises, the payment of interest is generally a share of the profit generated by capital applied to production or circulation of commodities. At the broadest level, the systematic basis for the payment of interest in this context is the increased turnover of total capital achieved by the mobilisation of idle money and its application to functioning circuits of capital through lending. More concretely, individual firms will be able to increase the returns on their own capital by leveraging it through borrowing, so long as the return on applied capital exceeds the rate of interest. Finally, given that debt-holders must be paid in order to avoid bankruptcy, high levels of debt may be used as a lever to keep enterprise-costs down, most often by lowering or keeping down total wage-payments.¹⁶

Under normal conditions, loanable money-capital advanced to a capitalist enterprise will help generate the source of its own repayment with interest, by circulating in the borrower's circuit and expanding through the appropriation of surplus-value. Finally, the relationship between capitalist lender and borrower is, at this level of abstraction, one between social equals who both enter the transaction on the basis of a profit-maximising calculus. An important expression of this equality is the hiring of financial officers, whose very jobs are to ensure the firm secures outside finance on the most advantageous terms possible. The social relations defined by lending to individuals are fundamentally different in most of these regards.

3.2. Lending to individuals

Lending to individuals has become a major part of banks' overall lending activities. This is evident for the banks surveyed here, particularly the top two US banks.

Table 4: Loans to individuals as percentage of total loan-portfolio, Dec 2006

HSBC	Citigroup	B of A	RBS	Barclays	Paribas	Dresdner	SMFG
40.5	77.7	76.3	24.0	44.0	33.0	20.1	26.8

15. Lapavitsas 2003.

16. This appears to be an increasingly common practice, particularly in firms controlled by private-equity groups aiming for fairly quick gains in market capitalisation.

Yet, even these figures understate the importance of this type of lending for the world's largest financial groups. The very organisation of Citibank, HSBC and Bank of America reveals their orientation to individual credit. Citibank's 'Global Consumer' business-segment generated profits of US\$12.1 billion, or 56 per cent of all profits, in 2006. Revenues from credit-cards and consumer-lending stood at US\$13.5 billion, or 31.6 per cent of all revenues. That same year HSBC's 'Personal Financial Services' segment, which focuses on consumption- and mortgage-credit, generated US\$9.5 billion in profits, 42.9 per cent of the total, ahead of commercial and investment-banking divisions, which accounted for 27.3 and 26.3 per cent of profits respectively. Central to this performance is HSBC's credit-card network of over 120 million cards worldwide. Bank of America's 'Global Consumer and Small Business' segment, which focuses centrally on consumption- and mortgage-credit and retail-accounts, accounted for 65.6% of net interest income that year.

This type of lending has a distinctly *exploitative* social content. Money loaned out to individuals for consumption or mortgages does not ordinarily generate the value from which it is to be repaid with interest.¹⁷ Interest-payments are generally made from subsequent wage-receipts by borrowers, representing an appropriation of value borrowers have secured independently of the loan. Recent innovations in consumer-lending involving the international operations of banks like HSCB and Citibank offer a congealed expression of this direct appropriation. Along with other banks across Latin America, these banks offer wage- and pension-linked loans that often include a legal agreement by the borrower's employer or the state to deduct loan-repayments directly from payroll.

At least two concrete factors condition the exploitative character of lending to individuals. First, the relationship is profoundly unequal. It involves, on the one hand, a specialist in managing money-flows trying to maximise profits, and on the other, an ordinary wage-earner trying to secure access to consumption. A range of patterns deemed 'irrational' by mainstream-economic analysis follow, including the tendency for consumers to continue using the first card they ever obtained, regardless of its comparative rates.¹⁸ Also, lending rates are often 10 to 20 percentage points above base-rates. The high relative profitability of this type of credit suggests high rates of interest do not arise from lower repayment-rates. HSBC, for instance, generated 42.8 per cent of its profits from lending to individuals and related fees in 2006, while allocating only

17. An obvious and partial exception to this relates to residential real-estate bubbles, which open the possibility for temporary leveraged capital-gains in housing-assets for some households. The instability, inequity and destructive power of this type of bubble needs no explanation at this point.

18. Gruber and McComb 1997 point to evidence of this for the US economy.

29.4 per cent of its total assets to such activities. Significant economies of scale in credit-scoring methods compound these effects, reducing the scope for competition.¹⁹

Second, the scope for exploitation through lending to individuals has increased in the past two decades. The privatisation of provision for a number of basic social necessities has increasingly forced ordinary individuals into debt, transferring growing shares of their incomes to banks and other financial enterprises. The most obvious example is housing, where provision for the working class and poor has become synonymous with facilitating private ownership through the development of mortgage-securitisation markets. As Table 5 shows, mortgage-lending accounts for a very high fraction of lending to individuals for these banks.²⁰

Table 5: Mortgage-loans as percentage of total loans to individuals, Dec 2006

HSBC	Citigroup	B of A	RBS	Barclays	Paribas	Dresdner	SMFG
53.6	33.1	59.1	72.9	73.0	N/A	33.3	98.1

Another significant item is education, where growing costs have increasingly fallen directly on individual students and their families across a range of countries. This has opened yet another avenue for direct exploitation by banks. In 2006, Citibank reported US\$220 million in profits from its US student-loans division alone.

Credit-cards are another important part of this lending. Banks in the US moved aggressively to concentrate the industry as it grew in size and profitability in the 1990s. In 1995, they held no more than 25 per cent of credit-card receivables in the US.²¹ As late as 1999, the top ten US issuers controlled 55 per cent of the market; many of them were independent credit-card companies.²² Since then, large banks bought their way into dominant market-share, acquiring Associates, Bank One, British-based MBNA, and Providian. After 2004, the top ten US issuers controlled over 90 per cent of the market, and counted only one independent, non-bank enterprise.²³

19. Mester 1997.

20. These figures include home-equity withdrawals, which are best understood as consumer-credit. Even in Britain, where such withdrawals were exceptionally high, they never amounted to more than 20 per cent of mortgage-credit.

21. Allen and Santomero 2001.

22. Land, Mester, and Vermilyea 2007.

23. JP Morgan, Citigroup, Bank of America, the independent Capital One, HSBC and Washington Mutual held the top seven spots at the time. See Akers et al. 2005.

The broader significance of this orientation to individual lending cannot be overstated. In the US, against a background of stagnant real wages, the financial obligations of households is estimated to have increased from 15.36 to 19.35 per cent of disposable income between 1980 and 2007.²⁴ The volume of transfers from households to the financial sector on this account is unprecedented. And, as the current financial crisis shows, this lending has introduced a distinct, new source of instability to financial markets.

3.3. *Money-dealing fees*

Banks have always earned income from the plain handling of money, such as operating the payments-system, transmitting money abroad and undertaking foreign-exchange transactions. Banks are money-dealers, or commercial enterprises that specialise in managing money-flows and hoards.²⁵ Money-dealing and account-related fees are very important sources of income for contemporary banks. They have also generated considerable controversy, including in Britain, where the Office of Fair Trading has for a number of years been trying to curb overdraft and related bank-fees widely perceived to be excessive and opaque. The figures for fee-income from card- and account-services for the surveyed banks tell their own story, particularly for Bank of America and British banks.

Table 6: Card- and other account-service charges, 2006²⁶

Bank	2006		2007	
	US\$ billion	Revenue-Share	US\$ billion	Revenue-Share
HSBC	9.00	12.8%	10.86	12.4%
Citigroup	6.78	7.6%	7.22	8.8%
Bank of America	22.51	30.5%	22.99	33.8%
RBS	9.1	17.7%	10.08	16.2%
Barclays	11.10	27.9%	12.73	27.6%
BNP Paribas	2.53	7.2%	3.07	7.2%
Dresdner	0.33	3.9%	0.35	4.7%
Santander	1.53	5.5%	1.95	5.7%
SMFG	1.58	9.6%	n/a	

24. See Federal Reserve, Household Debt Service and Financial Obligations Ratio.

25. See Lapavistas 2007.

26. See appendix for explanation of categories used in different corporate reports to obtain all data reported in this section. The figure given in this table for RBS also includes retail-fee revenues not associated with money-dealing.

Bank of America and Citigroup together received almost US\$30 billion in fees from money-dealing services to individual accounts in 2007. In Britain, Barclays received more than a quarter of its revenues in 2007 from banking- and credit-fees, a slight decrease in significance in relation to 2006, when the British Office of Fair Trading implemented rules limiting late and overdraft-fees.²⁷ Together with HSBC it made out with a total of US\$23.607 billion in fees from money-dealing activities in 2007.

An important part of these revenues relates to credit to individuals. Overdraft-charges, late-payment fees, credit-card charges, etc are levied as fees but are part of consumer-lending. Bank of America attributed the significant rise in its non-interest income between 2005 and 2006 to its purchase of British-based credit-card issuer MBNA, which resulted in increases in excess servicing, cash-advance, and late fees. Similarly, Furnace reports that total US late credit-card fees rose from insignificant levels in 1990 to over US\$1 billion in 1996, and to almost US\$9 billion in 2003.²⁸ As such, they should also be understood as exploitative.

Other account-related fees relate to account-management and other money-dealing services. Some of these are new and relate to new access-services, such as ATMs, phone and internet-banking facilities. Banks have incurred significant fixed costs in establishing these new facilities, and their introduction is yet to translate into reductions in overhead-costs. Bank clients have become heavy users of the new technologies, increasingly using cards and making frequent ATM withdrawals to access consumption.²⁹ Growing money-dealing fees, thus, may in part amount to payments by ultimate users of new, expensive, technologies. But their persistence and opacity, the magnitudes involved, and their intrusion into the very process of consumption suggest the presence of exploitative elements in them.

While further research is necessary on this particular account, it is clear that, in both lending and money-dealing services, banks have re-oriented to private-wage income as a source of revenues. The resulting relations contain important exploitative elements. Significant as the resulting profits are, they do not exhaust the current scope for bank-appropriation of wage-earnings. The growing scope of financial-market mediation activities have afforded banks additional avenues for bank-profits grounded on wages. The next two sections turn to those activities and the social content of contemporary capital-markets.

27. Shareholders can be reassured that the ensuing losses in revenue were at least partially made up for with growth in Barclaycard International. See Barclays 2008, p. 30.

28. Furnace 2004.

29. See Berger and Mester 2003 and Lapavistas and dos Santos 2008.

4. Financial-market mediation

Facilitating access to capital-markets has emerged as an important activity for commercial banks over the past twenty years. As Table 7 shows for 2006, revenues from these activities are very important for the surveyed banks, particularly European ones. The nine banks grossed US\$113 billion on this account that year.

Table 7: Revenues from financial-market mediation as percentage of total revenues, 2006

HSBC	Citi	B of A	RBS	Barclays	Paribas	Sant'dr	Dresd'r	SMFG
19.5%	14.6%	16.6%	30.5%	37.8%	58.1%	19.0%	50.8%	6.6%

These revenues arise from a range of activities, from conventional investment-banking functions of underwriting, brokerage- and corporate-advisory services to investment- and insurance-fund management and the issuance and dealing in derivative-assets. Associated with all these activities are the increasingly significant capital-gains made by banks on their trading and own accounts.

The view motivated in the next two sections is that, through these functions, banks appropriate fractions of existing loanable money-capital ultimately owned by the mass of all investors. As with ordinary lending, the social character of the relationship banks have with capitalist clients is fundamentally different from that of their relationship with retail-savers. In the current setting, there is scope for systematic mutual gains in arms-length relationships between investment-banks and corporations and other financial intermediaries. Those gains are ultimately funded by flows of loanable money-capital owned by the mass of investors, who are increasingly ordinary savers. In contrast, the relationship between banks and average retail-investors appears in the present context as exploitative, as banks systematically appropriate value by mediating future retirement-consumption.

In order to establish these points it is necessary to characterise the functioning of capital-markets and the intervention in them by banks. This requires the extension of existing Marxist theory. No significant Marxist contribution has been made to this analysis in the hundred years since Hilferding's 1910 seminal work. And despite its many insights, *Finance Capital* presents problems in its approach to the concept of *founder's profit* as well as in the contemporary relevance of its core concept of *finance-capital*, both of which lie at the heart of Hilferding's conceptualisation of the integration of corporations, capital-markets and investment-banks.

Section Five below offers initial analytical elements of a Marxist approach to the contemporary form of those social relations. Before that, this section documents the relative importance of revenues from fund-management, proprietary gains, and derivatives-trading for top international banks.

4.1. *Fund-management*

As already mentioned, managed funds held a total of US\$63.8 trillion in assets at the end of 2006. Even small management-fees on such volumes can lead to appropriations of very large sums of loanable money-capital. In the US alone, mutual-fund management-fees have grown considerably since 1980.

Table 8: Total mutual-fund fees paid by holders in US, US\$ billion

1980	1985	1990	2000	2001	2002	2003	2004	2005	2006
0.0	0.2	1.1	3.4	11.0	8.9	9.1	10.3	10.6	11.8

Source: Investment Company Institute

In the US, investment-banks and brokerage-houses were the first firms to profit from the new mass-retail investment-funds. In 1980, the top ten New York investment-banks earned less than one per cent of their revenues from asset-management fees. By 2004, top investment-banks earned 7.5 per cent of their revenues from such fees.³⁰ After the 1988 partial relaxation of Glass Steagall restrictions, US commercial banks were offering mutual-fund shares, albeit selling them for an ‘administrative fee’ and not an ‘underwriting commission’ or ‘brokerage fee’.³¹ In 1989, commercial banks already had 7 per cent of US mutual-fund assets under their management. By 1995, this had risen to 15 per cent.³² Worldwide, the nine banks surveyed and their financial-group partners controlled at least 10.2 per cent of the entire managed-fund market in 2006, a share on par with the combined total for investment-banks UBS, Credit Suisse, JP Morgan, Goldman Sachs, and Deutsche.³³ The importance of these activities is evident in the banks’ revenue-figures.

30. See Morrison and Wilhelm 2007.

31. McGrath 1989.

32. Neely 1995.

33. Insurance-companies and independent intermediaries controlled 50 per cent at the end of that year. Calculated from Watson Wyatt 2007.

Table 9: Fund-management commissions and fees

Bank	2006		2007	
	US\$ billion	Revenue-Share	US\$ billion	Revenue-Share
HSBC	2.98	4.2%	2.59	3.1%
Citigroup	1.44	1.6%	1.97	2.4%
Bank of America	4.21	5.7%	3.38	5.0%
RBS	9.1	17.7%	10.08	16.2%
Barclays	2.83	7.1%	3.58	7.8%
BNP Paribas	2.37	6.8%	2.91	6.8%
Dresdner	0.42	4.9%	0.45	6.1%
Santander	2.24	8.0%	2.59	7.6%

The revenue-share is broadly higher for banks operating in Europe, where banks and insurance-companies overwhelmingly control the market. Independent funds still maintain a significant market-share in the US.³⁴

Mutual-fund holdings, at least in the US, are widespread among middle-class professionals as well as ordinary working-class wage-earners. As of 2006, 53 per cent of households owning mutual-fund shares had a total annual income below US\$75,000; 28 per cent earned less than the median of approximately US\$50,000.³⁵ The attraction of mutual funds for small holders of loanable money-capital, for whom direct access to capital-markets is too costly, time-consuming, or complicated, is access to rates of return higher than those available through commercial bank-deposits or mostly safe government-securities. Yet the social realities of the relationship cannot be escaped. Retail-investors are various types of wage-earners approaching it on the basis of securing future (typically retirement) consumption. Fund-managers are well-connected financial professionals seeking to maximise profits.

The results are startling. The *Economist* (1 March, 2008) has reported on research by top US fund-management firm Vanguard showing that, between 1980 and 2005, the S&P 500 share-index returned 12.3 per cent per year on average. Over the same period, the average equity mutual fund yielded only 10 per cent. The average investor gained only 7.3 per cent on average per year,

34. See BCG 2003.

35. Investment Company Institute 2007. For reference, in May 2007, a household with a full-time assembly-line worker and a full-time teaching assistant, each making average earnings, would have earned US\$ 49,300. See Bureau of Labor Statistics, <www.bls.gov>.

largely due to the strong tendency of retail-investors to buy high and sell low. The return realised by the average equity mutual fund-investor is not much higher than rates available for long-term savings-deposits. Over the same period, US six-month T-bills yielded an average 6.00 per cent, while US municipal and local government 20-year bonds yielded an average 6.92 per cent.³⁶

The significance of these differences can be illustrated by considering a hypothetical investment of \$100 made in 1980.³⁷ If it were invested in safe T-bills, by 2005 the investor would hold \$454.94. In contrast, had it been invested in S&P index securities, it would have grown to \$2,041.14. The total premium for investing in equity over T-bills over this period stood, thus, at \$1,559.20. Now, consider a wage-earner hoping to save for retirement who tried to take advantage of those potential gains by investing \$100 in an equity mutual fund in 1980. Earning only the average return received by equity mutual-fund investors over this period, her investment would have only grown to \$624.59 by 2005. This represents a gain over the safe T-bill investment of \$169.65, or a mere 10.9 per cent of the total potential gains from equity-investment!

The remaining 89.1 per cent were appropriated by fund-managers and other financial-market firms. This includes appropriation through commissions and fees on investment-funds as well as the trading and proprietary gains discussed below. Unsurprisingly, fund-management is remarkably profitable. In an international survey of money-fund managers' performance in the lean year of 2002,³⁸ Boston Consulting Group 2003 found that 64 per cent of the funds reported pre-tax profit-margins above 20 per cent. A full 42 per cent of the funds reported profit-margins higher than 30 per cent. Funds targeting retail-investors were reportedly the most profitable.³⁹

Although the thought-experiment pursued here is no substitute for more comprehensive empirical study, its results suggest these activities have a strong exploitative element, particularly given the high profitability of fund-management. By providing pension-savings services that used to be provided by the state, fund-managers mediate future consumption and appropriate loanable money-capital originating in the wages of ordinary retail-investors. As discussed in Section 5 below, the bases for these systematic flows of value arising in the sphere of exchange in capital-markets ultimately lie in the

36. Calculated with monthly data from Federal Reserve's Selected Interest Rates.

37. Assuming each instrument paid its average annual return over the period every year.

38. Including seven of the top ten fund-managers by asset, plus another 33 who collectively controlled over one-fifth of the world-market.

39. Morrison and Wilhelm 2007 discuss extensively the significant economies of scale present in retail-investment fund-management.

fundamental class-differences between retail-investors on one hand, and banks and corporate managers on another.

4.2. *Proprietary trading*

Commissions and fees from fund-management are only one of the ways in which banks performing investment-banking and fund-management services can profit at the expense of investors, particularly retail ones. Investment-banking and fund-management activities naturally pose opportunities for banks to make capital-gains on securities. Underwriting requires banks to make investments in the securities being issued. Brokers often stand in as counterparty for client-transactions with volumes that could alter market-prices, in which case banks charge clients a margin on the security's current price. And banks increasingly invest in the companies they advise, on which they have intimate knowledge.⁴⁰ Finally, when retail-investors buy high and sell low, a bank is often the counterparty to the transaction. To the extent that the bank possesses better knowledge about capital-markets and has the financial clout to withstand and take advantage of even moderate downturns, it will profit handsomely from such transactions.

This is a controversial issue, as it is rightly perceived to pose potential conflicts of interest between the bank and its clients, and to be fertile ground for the manipulation of markets at the expense of other investors.⁴¹ Banks are generally reluctant to report which transactions are carried out for clients and which are carried on a principal basis. Further complicating matters, this type of gain can accrue not only on listed own investment, but also on securities held for trading as part of brokerage-services for both institutional and retail-clients. The combined figures for gains on those accounts gives a good sense of the importance of this type of revenue for commercial banks.

Collectively, the nine banks surveyed made profits of US\$58 billion in 2006 from such gains. For its part, Goldman Sachs made over US\$25 billion on this account that year, more than enough to cover the employee compensation-bill of just over US\$16 billion.⁴²

The subprime crisis also highlighted the importance of these activities. While some of the surveyed banks suffered losses in outright mortgage- and other consumer-loans, centrally in US markets, the main impact on these banks took place through their trading-account holdings of subprime mortgage

40. See Morrison and Wilhelm 2007.

41. See, for instance, Blackburn 2006 for accounts of a number of instances of market-manipulation.

42. For an average of just under US\$622,000 per employee.

Table 10: Own and trading-account gains

Bank	2006		2007	
	US\$ billion	Revenue-Share	US\$ billion	Revenue-Share
HSBC	8.86	12.6%	13.89	15.9%
Citigroup	5.76	6.4%	-8.00	
Bank of America	5.57	7.5%	-3.92	
RBS	11.48	22.2%	12.39	19.9%
Barclays	8.42	21.2%	9.96	21.6%
BNP Paribas	11.22	32.0%	14.17	33.4%
Dresdner	3.57	41.7%	-0.66	
Santander	2.70	9.6%	4.10	12.1%
SMFG	1.08	6.6%	n/a	
UBS	10.97	33.2%	-6.96	
Goldman Sachs	25.56	67.9%	31.23	67.9%

CDOs. The 2007 trading-account losses in credit- or structured products for Citigroup, Bank of America and Dresdner stood at US\$ 21.806 billion, 5.176 billion, and 468 million, respectively. While posting net overall trading-account gains, RBS, Barclays, and HSBC registered net trading losses in credit-instruments amounting to US\$2.861 billion, 823 million, and 419 million. Some of these losses were associated with holdings for trading, as these banks mediated purchases by many hedge-funds investing in subprime mortgage CDOs.⁴³ But the sheer volume of losses suggests these holdings were to a significant extent proprietary in that they were motivated by the hope of returns on holding these assets.

4.3. *Derivatives*

Investment- and commercial banks have engaged heavily in issuing, trading, and market-making for derivative-assets. Markets for over-the-counter (OTC) interest-rate and foreign-exchange derivatives have grown tremendously in the past twenty years, reaching almost US\$400 trillion in notional amounts outstanding in June of 2007, according to the Bank for International Settlements. Although insignificant as recently as the end of last century,

43. Dodd 2007.

the volume of credit-default swaps has also increased dramatically in the past seven years.

Table 11: Credit Default Swaps, notional amounts outstanding at year-end, US\$ trillion⁴⁴

2001	2002	2003	2004	2005	2006	2007
0.92	2.19	3.78	8.42	17.10	34.42	42.58

Sources: International Swaps and Derivatives Association Market Survey, BIS

Banks were naturally placed to lead the way as derivative-markets developed. They were the first enterprises affected by the increased risks posed by interest- and exchange-rate liberalisation starting in 1973. They became pioneers in deploying hedging techniques with interest-rate and foreign-exchange derivative-contracts as part of their own risk-management. It is difficult to identify the revenues banks raise from issuing these assets and gains they make on their trading accounts as they are not reported separately. What is clear is that six of the nine commercial banks surveyed have prominent market-positions. According to Emm and Gay, Citigroup, Bank of America, BNP Paribas and RBS have been recently among the top seven dealers of derivative-assets worldwide. HSBC and Barclays also have a solid presence in US markets.⁴⁵

Table 12: Selected OTC derivatives-dealers in United States by market-share, June 2007

Bank	US, 2007	Ranking
JP Morgan	51.3%	1
Citigroup	20.7%	2
Bank of America	19.5%	3
HSBC	2.9%	4
Wachovia	2.7%	5
ABN Amro	0.8%	13
Barclays	0.4%	19

US Office of the Comptroller of the Currency, Quarterly Report on Bank Derivatives Activities

44. Except in 2007, for which the end of June figure is given.

45. Emme and Gay 2005.

The investment-banking functions of these banks naturally placed them in a position to sell derivative-contracts to corporate clients. As discussed below, those assets may help improve capital-market perceptions of a corporation's liabilities, thus lowering their cost of capital and creating the basis for the payment of issuance-fees. Despite the fact that non-financial corporations make heavy use of these assets,⁴⁶ financial intermediaries account for the bulk of OTC markets, particularly for credit-default swaps.

Table 14: OTC derivative contracts with financial firms, per cent of total, June 2007

Foreign Exchange	Interest Rate	Credit Default Swaps
78.8%	86.9%	97.9%

Source: Calculated from BIS Semiannual OTC derivatives statistics

As with corporations, financial intermediaries may acquire derivative-assets to improve market perceptions of their position and liabilities. Banks increasingly use credit-default swaps, as part of holding and dealing in structured debt-products like CDOs, as well as to lower the regulatory capital-cost of holding debt-securities under Basle II capital-adequacy conventions.⁴⁷ Insurance-companies, investment- and hedge-funds regularly acquire derivative-assets from dealers in order to conform their positions with the expectations and requirements of customers and regulators. Gains made from these improvements provide the foundation for payments of fees for obtaining derivative-contracts. It should be noted here that the most important function of a derivative-asset in this connection is not necessarily to change the prospects of the buyer, but to change the *perception* of those prospects by other capital-market players.⁴⁸

Whether bought for hedging or pure speculation, derivative-assets yield fees to issuing banks. Like good bookies, issuers generally maintain a neutral position to either side of all markets. Issuance-fees represent various appropriations of existing loanable money-capital, centrally from institutional

46. The International Swaps and Derivatives Association reports well over 90 per cent of the world's top 500 corporations regularly use over-the-counter derivatives.

47. By reducing the measured risk of an asset-holding and, thus, lowering the corresponding risk-weighted capital-reserves.

48. Millo and MacKenzie 2007 eloquently emphasise this aspect of derivative-markets, particularly in relation to the prevalence of pricing models based on the basic models of Black and Scholes 1973 and Merton 1973 whose mathematical foundations yield easily authoritative prices, regardless of their empirical purchase on reality.

investors drawing funds from the mass of retail-investors. As such, bank-profits from this issuance also represent systematic transfers of value from the mass of retail-investors to the financial sector.

5. Capital-markets, investment-banking and Marxist theory

The increasing significance of financial-market mediation to capitalism in general and for commercial banks in particular poses a considerable analytical challenge for Marxist political economy. These activities can be highly complex, and many of them are historically novel. Identifying their social content requires development and extension of Marxist theory.

Building on Marx,⁴⁹ Hilferding offers the best developed Marxist approach to capital-markets. Yet, despite its important insights, the book's approach to the integration of corporations, banks and capital-markets is defined by the concepts of *finance-capital* and *founder's profit*. Subsequent developments in capitalism have pointed to empirical and analytical weaknesses in both concepts. As the discussion above suggests, contemporary capitalism is not characterised by the merger of banking and industrial capital.

The concept of *founder's profit*, as formulated by Hilferding, also poses difficulties. It refers to a peculiar capital-gain realised by a corporation's founders when equity is issued and sold because buyers expect and receive only the basic rate of interest as a return on their investment. In this, he followed very closely on the steps of Marx, for whom the rate of interest represented the general mode of appropriation for all holders of money-capital, regardless of the instruments employed.

Yet, historically, expected and realised equity-returns have exceeded returns on bills and bonds over long periods of time.⁵⁰ More importantly, this view makes it impossible to characterise the social content of relations defined by investment-banking activities.⁵¹ Put most simply, if corporations can directly raise capital at the rate of interest, there is no reason for them to engage the

49. Marx 1909.

50. A wide literature documents the superior returns on equity over bonds in the US throughout the twentieth century. In the postwar-period, US equity-returns have yielded an average excess-return of 5.5 per cent over bills (DeLong and Magin 2007). Besser 1999 also presents evidence from Germany between 1870 to 1995 showing that equity-returns, while highly volatile, have been consistently higher than bond-returns over long investment-horizons.

51. In Hilferding, these relationships are rather simple. Banks fused with and controlled industrial capital and the resulting *finance-capital* appropriated the totality of founder's profits, and increasingly dominated economic, social and political life within rival national imperialist blocs.

costly services of investment-banks and little content to financial-market mediation.

Starting from these appreciations, and the most general and compelling foundations of Hilferding's approach to capital-markets, this section aims to make a modest and preliminary contribution to a Marxist theorisation of capital-markets, investment-banking and financial-market mediation. The discussion affords a general characterisation of the social necessity and inherent contradictions of capital-markets and investment-banking in capitalism, as well as an elucidation of their parasitic class-content in the concrete historical setting prevalent since the early 1980s.

5.1. *Capital-markets, risk and investment-banking*

Capital-markets are markets for securities representing: rights to different future cash-flows paid by corporations. In the first instance, corporations enter capital-markets to raise funds for investment. Loanable money-capital enters capital-markets seeking self-expansion through the future cash-flows associated with securities and possible capital-gains. Two broad types of securities are traded, bonds and equity. Bonds are debt-claims and holders are entitled to the payment of interest. Equity represents a claim on residual profits of enterprise in the form of dividends; it may also legally represent voting rights at corporate meetings. Capital-gains may be realised on any security when a holder sells it for a price higher than its purchase-price.

Capital-markets effect a socialisation *sui generis* of debt and of capital itself, with potential benefits for the capitalist class as a whole. In the purchase of any non-marketable enterprise-liability, the value advanced by the buyer loses the flexibility and general acceptability it had when it was in the form of loanable money-capital. Loanable money-capital is transformed into commodities in the enterprise's circuit of capital, and its transformation into more value hinges on the vicissitudes of that circuit over time. This loss of liquidity can be ameliorated through developed capital-markets. Liquid markets for corporate securities allow security-holders readily to realise value into money, which is not only the most flexible, independent and socially-recognised embodiment of value, but the very purpose of the advance of loanable money-capital. Increased liquidity will attract larger volumes of money seeking a security, generally reducing the cost of outside finance.

Bonds and equity give holders rights to uncertain future flows of money. As with ordinary loans, their prices are irrational from the perspective of Marxist political economy in that they are money-expressions of the value of future money. Prices are determined unanchored, through the competitive interaction of supply and demand. In the capitalist setting of competitive individual

appropriation, this relative detachment poses a range of difficulties, including problems of trust and confidence between parties in a setting of anarchic uncertainty about the economic future.

It is in relation to these difficulties that corporate ‘financial engineering’ and investment-banking acquire social significance by possibly assisting a corporation to reduce its financing costs or generate capital-gains. In general, all developments that increase the profitability of an enterprise will also increase equity-prices – higher rates of exploitation, leadership in the installation of new techniques of production, increased control of markets, and so forth.

But the detachment of capital-market prices from underlying realities of accumulation creates other potential sources of capital-gains (or losses) that have no direct relationship to underlying real investments or profitability. A generalised expectation of future security price-rises will often in itself increase demand, leading to further price-rises that, for some time, yield considerable profits and appear to validate expectations. Sheer manipulation, including by investment-banks, has often been an integral part of such processes. Capital-markets and investment-banking inherently create the possibility of such speculative bubbles and their devastating consequences.⁵²

Yet capital-markets also create a systematic foundation for investment-banking functions and profits that does not by itself involve swindles, bubbles or manipulation: potential improvements to the social perceptions of the risks associated with the self-expansion of value through a particular corporate security. These may lower the cost of raising capital and generate capital-gains that sustain investment-banking fees and profits.

As generally noted by Hilferding,⁵³ investors’ perceptions of risks associated with security-returns play a defining role in the demand for securities. Specifically, security-buyers will try to assess the potential problems posed by its future cash-flows and its reconversion into money. Thus the perceived creditworthiness and liquidity of a security are central determinants of demand.

The less creditworthy or liquid a security is perceived to be, *ceteris paribus*, the smaller demand for it will be. Resulting security-prices will be lower, and the expected future cash-flows accruing to holders will represent a higher yield on initial investment. Similarly, two securities with different expected potential future cash-flows, but with the same perceived creditworthiness and liquidity,

52. Effects are often compounded by leveraging of investments made on the basis of such self-fulfilling expectations. Returns may be astronomical while the bubble lasts, making not jumping into it very difficult in the context of general competition in capital-markets. See Kindleberger and Aliber 2005 for a good historical account of such crises.

53. Hilferding 1981, p. 108.

will see their present prices move until both yield the same expected return. As a result, systematic ‘risk premia’ arise in capital-markets: a general positive association between expected returns on a security and the perceived risks to the self-expansion of loanable money-capital it poses.

The potential benefits of investment-banking operations in this regard are most clear when considering the issue of a new corporate security. Neither its liquidity nor its creditworthiness can be guaranteed a priori. Investment-banks help redress this situation in the first instance through underwriting. They commit to buy the new security at a particular price, assuring buyers of its ready reconversion into money and signalling the bank’s confidence in its creditworthiness.

As argued and historically illustrated by Morrison and Wilhelm, investment-banks are able to do this given their position and relations within social and business-networks of corporate managers, individual investors, and managers of institutional funds.⁵⁴ On the security-selling side, the banks are responsible for ‘due diligence’ on the issuer’s conditions, making use of their specialisation in credit-enhancement. On the buying side, the bank engages in ongoing consultations with a network of close private and institutional investors, gathering knowledge of prices those buyers would pay for the issue, and any aspects of the issue and issuer they may wish to see changed. Buyers agree to discuss these issues with the bank on the understanding they will be offered preferential access to the resulting security-issue. Banks also advise corporations on a range of issue-related and broader corporate-finance matters that may improve market-perceptions of a corporation’s securities. This often includes advising on the management of total security-supply, or selling derivative-assets to reduce perceptions of risks associated with the issuer.

All insiders generally gain as a result of these activities. The initial buyers, who are individual or institutional clients of the bank, get a first shot at buying securities that, if the bank has done its job well, will likely appreciate significantly in the short run. The issuer faces a lower cost of capital. And the bank receives fees, typically in the form of a discounted price on the issued security in relation to the offer-price.⁵⁵

Corporate managers and investment-banks may also try to generate capital-gains on old issues of equity by employing similar methods. Whether the securities are new or old, all such gains are funded from the loanable money-capital of outside buyers. Those buyers accept higher security-prices because

54. Morrison and Wilhelm 2007.

55. Chen and Ritter 2000 report this discount is usually around seven percent of the listed price.

they come to *perceive* better prospects or fewer risks associated with ownership of the security in question.

The uncertainty, competitiveness and relative detachment of capital-market operations ensure they are directly shaped by historically concrete social conventions and sustained practices among market-participants.⁵⁶ This includes perceptions about securities, which may be generally shared and sustain transactions even while at considerable variance from the realities underpinning the value of securities.⁵⁷ This gives rise not only to potential instability, but also to possible systematic advantages to market-participants better able to shape and apply capital-market conventions and practices.

5.2. *Bonds, equity, and capital-market returns*

Capital-market competition imposes general constraints to potential gains from these activities, as well as certain tendencies in the quantitative relationship between capital-market and real-accumulation rates of return. It is useful to consider separately bonds and equity in this regard.

Bonds embody credit-relations, not fundamentally different from those created by bank-loans. Their rate of return is a rate of interest, which is a sharing of profits. Its level will depend on the quantity and characteristics of other bonds, the relative perceived risk of the individual bond, and the amount of loanable money-capital seeking self-expansion in bond-markets. Private bonds ordinarily pay higher interest yields than state-paper regarded as safe. Bond-rates are typically measured as premia above returns on state-bonds.⁵⁸ The expected rate of return on a bond effectively demanded by buyers may account for expected capital-gains on the bond. Those could arise as the relative riskiness of the corporation's debt falls, or as overall demand for bonds increases. These are unlikely to be systematic as the management of corporations will not generally try specifically to increase the price of outstanding bonds.

Equity possesses a distinct relationship to the process of accumulation, involving returns realised through dividend-payments and capital-gains.

56. See MacKenzie 2003, for instance.

57. The current crisis has exposed a range of such cases in the credit-scoring models used in mortgage-lending, and in the estimation of future cash-flows associated with mortgage-backed CDOs. The methods used were adequate for convincing successive layers of security-buyers, but not for actually describing the objective characteristics of the security. See Lapavitsas and dos Santos 2008.

58. The existence of a large, liquid market for state-securities generally deemed as risk-free is an important underpinning in the development of liquid private bond-markets. The rise in volumes of private marketable debt since the early 1980s was accompanied by an equally impressive rise in the volume of outstanding marketable US Treasury bonds, notes and bills. Those rose from just over 20 per cent of GDP in 1980, to almost 45 per cent by 1997.

Equity-capital (in Marx's words, 'fictitious capital') does not represent an aliquot of real circulating capital. It entitles the holder to a pro-rata claim on future streams of dividends drawing on the profits generated by the circulation of capital. This is clear from the divergence of a corporation's market-capitalisation and net asset-values. Capital engaged in industrial or merchant-circuits appreciates through the *rate of profit*, established through mediations involving struggles at the point of production, the composition of capital, and competition in input- and output-markets. Equity-capital appreciates according to the *rate of return*, established through competition in capital-markets. While related, each of these rates represents fundamentally different social relations.

At purchase, the expected rate of return on a corporation's equity will generally be higher than the rate of interest on its bonds. Debt-repayment is generally more secure than residual gains on equity. In this important regard, the position articulated here differs from that offered by Hilferding, who argued that competition among buyers of equity would take returns on equity down to the rate of interest. Hilferding understood quite well the existence of risk-premia across different securities. But in his approach to capital-market securities he followed closely on Marx's own exposition in Chapter 23 of Volume III of *Capital* on the returns to loanable money-capital.⁵⁹ And, while Marx's exposition on the matter elucidates the objective foundation of interest-payments in the generation of profits by real capital, it also advances the rate of interest as the *general* return on all loanable money-capital, regardless of the financial and social relationship between the buyer and the seller or the type of security in question. It is impossible to approach risk-premia, which inherently involve individual securities and their returns, on such a basis.

The rate of return expected by new buyers of equity will depend on their perceptions of present profitability, their confidence in the security, as well as on their expectations of the future evolution of these factors.⁶⁰ Investment-banking and 'financial engineering' operations can affect these perceptions and expectations, reducing the expected rate of return demanded by new equity-buyers, and thus generating price-rises and capital-gains for incumbent owners.

The scope for gains from such activities will generally depend on the evolution of demand for securities in relation to supply, and on the capacity of

59. I owe this important observation on the origins of Hilferding's approach to Makoto Itoh.

60. Earlier versions of this article considered the simple case of equity issued by a corporation not expected to experience capital-gains and paying out all profits as dividends. In that case, expected returns on equity will not normally be higher than the corporation's rate of profit. If they were, market-capitalisation would be much lower than the price of the corporation's net assets. Eventually, either the corporation will buy back cheap equity, or it will be bought up and reformed or liquidated. Either way, the situation is unlikely to last very long.

corporate managers and investment-bankers to devise ways to increase the confidence in the security by potential buyers. This will hinge on historically specific practices and conventions that have acquired general acceptance in shaping capital-market perceptions,⁶¹ as well as on the specific composition of investors seeking to make gains from securities.

The steady privatisation of pension-provision and other necessities since the early 1980s created a unique setting in capital-markets. It not only greatly increased demand for securities, but also added a growing mass of ordinary savers onto capital-markets. The class-implications have been dramatic. On one side, we have seen corporate managers and investment-bankers nestled in extensive social and business-networks of capitalist investors and managers, organised professionally with the explicit purpose of maximising returns by shaping market-perceptions. On the other side, we have seen atomised individual savers whose engagement with capital-markets is primarily dictated by trying to access consumption – retirement, a child's education, a down-payment on a house, and so on.

It should not be surprising that the results of this encounter have proven systematically unfavourable to retail-savers. The relative detachment of capital-market operations from underlying realities of production, and their susceptibility to perceptions, conventions and – more recently – highly technical practices, tend to favour the well-connected capitalist relative to retail-savers. The dramatically different outcomes of capital-market trading for retail-investors and for financial intermediaries are not usefully understood as the product of the 'irrationality' of retail-investors. After all, financial intermediaries have amply proven their own capacity for 'irrationality'. Systematic uneven capital-market outcomes are simply an expression of the class-content of contemporary capital-markets.

While more analytical and empirical work are needed in this regard, it is clear that the foundation of the recent astronomical profits associated with investment-banking activities have ultimately been funded from the investments of ordinary savers. In a setting where these activities have not been generally associated with securing increased real investment – which could lead to general increases in productivity, wages, and standards of living – investment-banking during this period appears as monumental and crystallised class-parasitism.

61. Such as derivative-assets. See Milo and MacKenzie 2007.

6. Some concluding observations

A number of secular, policy and technological developments have fundamentally changed banking and its relationship to accumulation. Particularly in the US, non-financial corporations have become less reliant on outside finance in general and bank-loans in particular for their operational investments. Their relationship with capital-markets has consequently changed, and to a significant extent consists of 'financial engineering' operations aimed at capital-gains and involving the withdrawal of equity and bond-borrowings. The privatisation of pensions-provision has facilitated this change by triggering unprecedented inflows of loanable money-capital into capital-markets in the form of retirement-savings. Banks have placed themselves at the heart of these processes, offering mutually beneficial, arms-length investment-banking services to corporations. They have also pursued the provision of various investment-fund instruments to ordinary savers, who systematically receive very unfavourable terms in those services.

The steady privatisation of provision of a growing number of social necessities has also made access to money a precondition for the basic reproduction of ordinary wage-earners. Particularly in a setting of stagnant real wages and rising social inequality, this has forced wage-earners onto financial markets to secure mortgage-, education- and consumer-credit as well as private insurance-services. The relationships banks establish with them through those activities involve large and systematic appropriations of value drawing on individual income. As such, they are exploitative. While these changes are most clearly pronounced in the US and Britain, the micro-level evidence discussed in this paper suggests the new banking practices are spreading, distinctively, to other advanced capitalist economies.

The current financial crisis may be usefully understood as a crisis of this type of banking and attendant financial activities. Regulatory arbitrage and rising degrees of leveraging of financial intermediaries have played important roles in the crisis. Positivist hubris about the power of new, inference-based estimations of risk also played their part, as capital-market players came to believe that derivative-assets and their inference-based pricing formulae could actually describe and account for all market-eventualities. And competition among intermediaries ensured that even though many of them knew subprime mortgage-lending was going to lead to losses, they could hardly afford to miss out on the boom.⁶² To borrow from former Citigroup boss Chuck Prince III, when the music stopped, most banks were caught dancing.

62. HSBC 2007, p. 8, noted in March 2007 that much of its US subprime mortgage-portfolio had 'evidenced much higher delinquency than had been built into the pricing of these products'.

Yet, underpinning all of these factors was the drive by banks and broader financial system to increase the scope for financial expropriation. Unsurprisingly, problems arose as this expansion started to include historically oppressed layers of the US population with very low and insecure wage-incomes. The unfolding economic depression is adding to the system's problems as increasing volumes of 'prime' mortgages and other consumer-debt go bad.

Contemporary banking created the current financial crisis and is responsible for the consequent devastation of the lives of millions of people. It is also central to contemporary capitalism. Whatever happens over the next period, it is unlikely that bank-appropriation of value at the expense of ordinary wage-earners will collapse by the power of its own contradictions. The revenues have been far too significant, and the beneficiaries far too central to the socio-political fabric of the different advanced capitalist economies. The weakening of trade-union and of broader social organisations of ordinary people over the past thirty years facilitated the growing intrusion of the financial system into the everyday lives of ordinary wage-earners. It is the re-awakening of those organisations that can once again place on the agenda the social provision for housing, retirement, education, health and other necessities, as well as the broader desirability of conscious, democratic economic planning.

References

- Akers, Douglas, Jay Golter, Brian Lamm, and Martha Solt, 2005, 'Overview of Recent Developments in the Credit Card Industry', *FDIC Banking Review*, 17, 3: 23–35.
- Allen, Franklin and Anthony M. Santomero 1997, 'The Theory of Financial Intermediation', *Journal of Banking and Finance*, 21, 11–12: 1461–85.
- 2001, 'What Do Financial Intermediaries Do?', *Journal of Banking and Finance*, 25, 2: 271–94.
- Barclays 2008, *Annual Report 2007*, London: Barclays plc.
- Berger, Allen N. and Loretta J. Mester, 2003, 'Explaining the Dramatic Changes in Performance of U.S. Banks: Technological Change, Deregulation, and Dynamic Changes in Competition', *Journal of Financial Intermediation*, 12, 1: 57–95.
- Besser, W. 1999, 'Equity Returns, Bond Returns, and the Equity Premium in the German Capital Market', *The European Journal of Finance*, 5, 3: 186–201.
- Boston Consulting Group 2003, *Navigating the Maze, Asset Management 2003*, Boston: Boston Consulting Group.
- Black, Fischer and Myron S. Scholes 1973, 'The Pricing of Options and Corporate Liabilities', *Journal of Political Economy*, 81, May/June: 637–59.
- Blackburn, Robin 2006, 'Finance and the Fourth Dimension', *New Left Review*, II, 39: 39–70.

Despite promises to shareholders of 'restructuring this business to avoid any repetition of the risk concentration that built up', the bank reported losses of US\$1.8 billion in consumer-lending and US\$1.2 billion in investment-banking for the US operations one year later.

- Chen, Hsuan-Chi and Jay Ritter 2000, 'The Seven Percent Solution', *Journal of Finance*, 55, 3: 1105–31.
- DeLong, J. Bradford and Konstantin Magin 2007, 'The U.S. Equity Return Premium: Past, Present and Future', unpublished manuscript, University of California Berkeley.
- Dodd, Randall 2007, 'Subprime: Tentacles of a Crisis', *IMF Finance and Development*, 44, 4: 15–19.
- Emm, Ekaterina and Gerald D. Gay 2005, 'The Global Market for OTC Derivatives: An Analysis of Dealer Holdings', *The Journal of Futures Markets*, 25, 1: 39–77.
- Erturk, Ismail and Stefano Solari 2007, 'Banks as Continuous Reinvention', *New Political Economy*, 12, 3: 369–88.
- Furnace, David 2004, 'Why Overdraft Income Is Growing for Financial Institutions?', *Kentucky Banker Magazine*, March 2004, Louisville: Kentucky Bankers Association.
- Greenspan Commission 1983, *Report of the National Commission on Social Security Reform*, Washington, DC.: Social Security Administration.
- Gruben, William P. and Robert C. McComb 1997, 'Liberalization, Privatization, and Crash: Mexico's Banking System in the 1990s', *Federal Reserve Bank of Dallas Economic Review*, First Quarter: 21–30.
- Hilferding, Rudolf 1981 [1910], *Finance Capital*, London: Routledge & Kegan Paul.
- Itoh, Makoto and Costas Lapavistas 1999, *Political Economy of Money and Finance*, London: Macmillan.
- HSBC 2007, *Annual Report 2006*, London: HSBC Holdings plc.
- International Finance Corporation 2008, *Annual Report 2007*, Washington, DC.: World Bank Group.
- Investment Company Institute 2006, '401(k) Plan Asset Allocation, Account Balances and Loan Activity in 2005', *Research Perspective*, 12, 1: 1–20.
- 2007, *2007 Investment Company Fact Book, 47th Edition*, <www.icifactbook.org>.
- Kindelberger, Charles and Robert Aliber 2005, *Manias, Panics, and Crashes – A History of Financial Crises*, Fifth Edition, Hoboken: John Wiley & Sons, Inc.
- Lang, William W., Loretta Mester and Todd A. Vermilyea 2007, 'Competitive Effects of Basel II on U.S. Bank Credit Card Lending', *Federal Reserve Bank of Philadelphia Working Paper*, 07–9, Philadelphia: Federal Reserve Bank of Philadelphia.
- Lapavistas, Costas 2003, *Social Foundations of Markets, Money, and Credit*, London: Routledge.
- 2007, 'Information and Trust as Social Aspects of Credit', *Economics and Society*, 36, 3: 41–36.
- Lapavistas, Costas and Paulo dos Santos 2008, 'Globalization and Contemporary Banking: On the Impact of New Technology', *Contributions to Political Economy*, 27: 31–56.
- Leyshon, Andrew and Nigel Thrift 1997, *Money/Space*, London, Routledge.
- Marx, Karl 1909 [1894], *Capital*, Volume III, Chicago: Charles H. Kerr & Company.
- McGrath, Kathryn B. 1989, 'Legislative and Regulatory Update: Banks and Mutual Funds', Speech given to 1989 American Bankers Association by SEC Director of Investment Management, 6 February, Washington, DC.: Securities and Exchange Commission.
- Merton, Robert C. 1973, 'Theory of Rational Option Pricing', *Bell Journal of Economics and Management Science*, 4, Spring: 141–83.
- Mester, Loretta 1997, 'What Is the Point of Credit Scoring?', *Federal Reserve Bank of Philadelphia Business Review*, September–October: 3–16.
- Millo, Yuval and David MacKenzie 2007, 'Building a Boundary Object: The Evolution of Financial Risk Management', unpublished manuscript.
- Morrison, Alan D. and William J. Wilhelm 2007, *Investment Banking, Institutions, Politics, and Law*, Oxford: Oxford University Press.
- Neely, Christopher J. 1995, 'Will the Mutual Fund Boom Be a Bust for Banks?', *Federal Reserve Bank of St Louis Regional Economist*, October.

Organization for Economic Cooperation and Development 2007, *Closing the Pensions Gap: The Role of Private Pensions*, Paris: OECD.

Watson and Wyatt 2007, 'The World's 500 Largest Asset Managers', available at: <www.watsonwyatt.com/research/deliverpdf.asp?catalog=PI_500_Analysis_2007>.

Appendix on Bank Corporate Reports

Unless otherwise noted, all information concerning individual banks was obtained from their respective Annual Reports for 2006 and 2007. The only exception is SMFC, for which the report for fiscal 2006–7 was used. Given the significant differences in accounting conventions across national regulators and individual institutions, it is necessary to specify the sources for particular data reported above. This is done by reported area of activity in the explanations below, which also include pertinent caveats and difficulties.

Credit-card and account-service charges

For all banks, these are fees from credit- and banking cards, and account-services. For RBS, total non-interest income from retail-operations is provided, which includes fund-management fees. For BNP Paribas, net commission-income not measured at fair value is given, which is a residual estimate of money-dealing commission and fees.

Financial-market mediation

The percentages are an understatement for SMFG and RBS, neither of which reported separate fund-management revenues. SMFG does not report narrow investment-banking revenues either. The figure given is exclusively for gains on own and trading account.

Fund-management and related commission-fees

The figures relate to net fees and or commissions on management of investment-, pension-, mutual and other funds. The exceptions are Citigroup, for which net income of Smith Barney and Private Banking divisions is given, and RBS for which fees earned at retail-level are given, which also include money-dealing fees.

Own and trading-account gains

For HSBC the figures are the sum of 'Net trading income and Net income from financial instruments'. For Citibank, they relate to 'Principal transactions' total revenue (the reported loss for credit-instrument tallied at US\$21.8 billion). For Bank of America and SMFG, they correspond to 'Trading account profits' plus equity-investment income and gains on sales of debt-securities. The bank's trading-account loss for 2007 stood at US\$5.13 billion. The figures for RBS include net gains from trading plus gains from investments, asset-backed activities, and rental. The figures for Barclays are from 'Principal transactions' and include net trading and investment-incomes. Santander's 'resultados netos de operaciones financieras' are reported. Paribas reports prominently on its net gains on financial instruments at fair value and on available-for-sale financial assets. The figures for UBS and Goldman Sachs are, respectively, for net trading income and trading and principal investments-income.

Copyright of *Historical Materialism* is the property of Brill Academic Publishers and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.