

THE PROFIT RATE IN THE PRESENCE OF FINANCIAL MARKETS: A NECESSARY CORRECTION

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In the past two decades the number, variety, and monetary value of marketable financial instruments, particularly securitized instruments, has grown by orders of magnitude. This is the most significant development in what many writers, for the most part Marxist, term ‘financialisation’¹. It brings to light, however, an anomaly in the way they calculate the profit rate. This calculation takes no account of the capital tied up in these instruments.

This article shows that when this omission is corrected, there is a consistent long-run fall in the UK and US rate of profit which, contrary to the figures widely used by Marxists, have both fallen almost monotonically since 1968.

Why does this matter? First, the profit rate figures prominently in Marx’s own theory, as is clear from his published works. It is the explicit subject of the first 15 chapters of *Capital* Volume III (Marx, 1981: 117-378) and dominates the remaining analysis. Second, the results shed light on current debates about the cause of the present extended crisis. A significant group of writers (see Choonara, 2011) argue that this is recent in origin, unconnected with the serious difficulties that beset Western economies in the 1970s, and follows a recovery from that crisis, brought about by neoliberalism, in the 1980s. Thus Husson:

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1 Duménil and Lévy, 2004, 2011; Lapavistas, 2009a, 2009b, 2010; Fine, 2009.

After the generalized recessions of 1974-5 and 1980-82, a new phase opened in the functioning of capitalism, one which one could for convenience call neo-liberal. The beginning of the 1980s was a real turning point. A fundamental tendency towards increasing the rate of exploitation was unleashed, and that has led to a continuous rise in the rate of profit (2008).

The idea that the profit rate, in the US at least, recovered in the 1980s is central to this argument: ‘[T]he profit rate reached a low at the beginning of the 1980s and has since been increasing’ (Duménil and Lévy 2004:1, 28).

However, most other economic indicators (see, for example, Freeman, 2010; Kliman, 2011) contradict the idea of a post-1970s recovery. The US economy has, for the past 30-40 years, performed worse than at any time since the 1930s. Taking averages from trough to trough, the average growth from 1939 to 1970 was 4.61%; from 1970 until 2009 it was 2.8%. For fifteen of the thirty years from 1939 to 1970, growth was higher than this 4.6% average; this was achieved in only six of the 39 years from 1970 to 2009. The profit rate plays a particularly critical role in the discussion, since it offers almost the only serious evidence of recovery. Thus, its accurate measurement is a matter of some concern.

The contrast is even sharper in the UK, which fewer Marxists have studied. UK economic performance since the mid-1970s has been even worse than that of the USA. Yet the rate of profit, as traditionally measured by Marxists, has risen more or less continuously since the early 1970s, as I will show. It is thus the only unambiguously positive indicator of economic health. In both countries, we must therefore take very seriously the possibility that it has been measured wrongly.

The UK and the USA have one critical factor in common: they are home to the world’s two largest financial markets. I will argue that this calls for a correction to the traditional measure of the profit rate. This correction leads to the conclusion that the profit rate has declined in these two countries monotonically since the crisis of the 1970s.

Two prefatory remarks are called for. First, these results are significant for non-Marxist theories in which the rate of profit also figures (see Toporowski, 1999). However, I focus on Marx’s concept because of its central role in his theory, which leads him to develop it farther than others. Moreover, I make use of a *differentia specifica* of his theory: within it, magnitudes of value express hours of labour. For non-Marxists

such as Kalecki (Toporowski, *op. cit.*) they are simply current money price magnitudes; for post-Sraffians (Pasinetti, 1979) they are ‘physical’ or use-value magnitudes. These differences affect both the measurement and interpretation of the results.

Secondly, I assume the reader is broadly familiar with the basics of the Marxist discussion, or willing to become so, if need be consulting standard sources like Howard and King (1989) or Kliman (2007). Wherever specific issues are referred to, I cite the relevant literature.

Profit Rate and Rate of Return: Differences of Conception and Measurement

We begin with definitions. Since we will propose a correction to the general consensus among Marxists, let us first note what they agree on. Marx himself defines the ‘general’ or ‘average’ profit rate as the total surplus value created in any given period, divided by the total social capital advanced at the beginning of that same period:

[T]he general rate of profit is formed by the average of the various different rates of profit in each 100 units of capital advanced over a definite period of time, say a year (Marx 1981:261).

What [the capitalists] secure is only the surplus-value and hence profit that falls to the share of each aliquot part of the total social capital, when evenly distributed, from the total social surplus-value or profit produced in a given time by the social capital in all spheres of production (Marx 1981:258).

When using official national accounts, although they may disagree about exactly how to quantify them, almost all Marxists use corporate surplus and fixed capital stock respectively as proxies for surplus value and capital advanced, being the numerator and denominator in the rate of profit. As regards the numerator, writers such as Moseley (1992) and Mohan (1996, 1998) argue that the relevant figure is the corporate surplus in the nonfinancial sectors, adjusting the traditional measure which includes all the corporate surplus in all sectors to allow for the perceived distortion caused by the unproductive financial and commercial sectors. Shaikh (2011:46) argues that ‘profit of enterprise’ – the rate of return on industrial investment after deduction of all other

claims on surplus value – is the magnitude most relevant to capitalist investment decisions. There are also differences on whether to use net or gross surplus, or whether pre- or post-tax profits are the most appropriate. More significant differences affect the denominator: adherents of the Temporal Single System Interpretation (TSSI) of Marx’s value theory (see Kliman, 2007) argue convincingly that fixed assets should be measured at historic cost, rather than the current cost measure used by other writers.

It is not the purpose of this article to assess or present these disputes. Rather, I take issue with the wide consensus among all Marxists, despite their many other differences, that the measure of capital advanced – the denominator in the rate of profit – should only include its fixed assets².

The central issue is this: the value advanced by capitalists is tied up in all phases of its circuit: not only in machinery, buildings, raw materials and inventories, but also in money balances, hoards, and financial investments. This is true even when the capital concerned is idle; money is in this respect no different from inventories or stocks of unsold goods. Indeed, this is Marx’s primary reason for rejecting Say’s law, and the foundation of his proof that capitalism regularly overproduces and fails to realize its product.

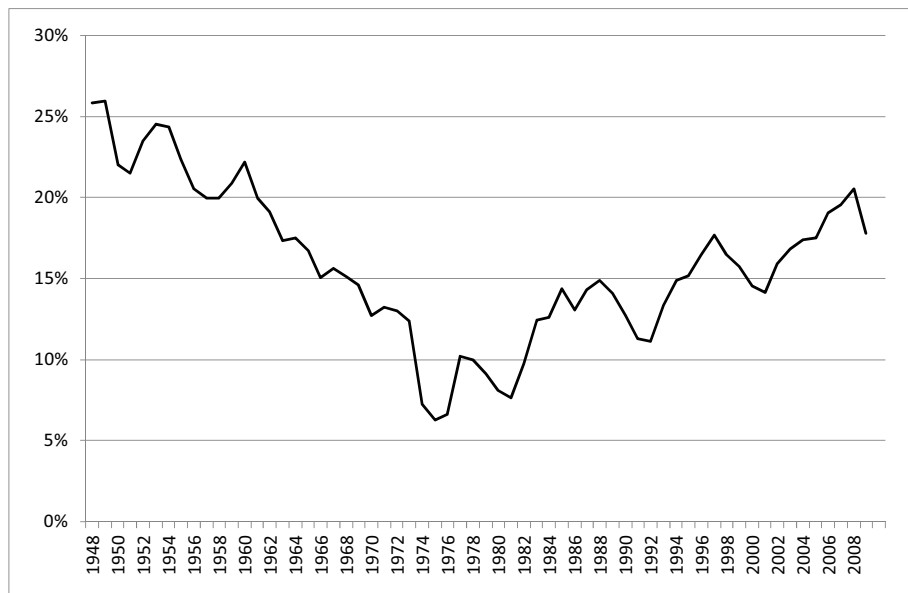
As long as money is held as idle balances which attract negligible income, the magnitude of money capital in the economy is governed, except for speculative holdings, by the general requirements of circulation, and any depressive effect on the general rate of profit is likely to be limited. This is confirmed by the results given below, which show no marked divergences until the last three decades. But it is precisely during these decades that money has come to be held in the form of marketable assets, and that holdings of them by capitalist enterprises has grown so massively. What happens to the profit rate if these marketable assets are included in total capital advanced?

The resultant correction, I will show, makes a highly significant difference to the rate of profit, whose trend then becomes consistent with

2 Fine (1985) is an important exception. Norfield (2012) offers an informative discussion of the theoretical need for some adjustment to the profit rate, including a fuller review of the literature than space allows here, but has not yet produced empirical measures of the adjustment.

the prolonged post-1970 decline in US and UK economic performance. This makes it theoretically sound and empirically necessary: it ‘makes sense’ of the profit rate data, and it is coherent with Marx’s theory of value, and with his theory of money and credit as developed in Volume III of *Capital*. It brings out the theoretical precision in Marx’s much-abused category of ‘fictitious capital’ and brings into line the treatment of the four derivative forms of surplus value which Marx analyses in Volume III of *Capital*: commercial profit, interest, profit of enterprise, and rent. That is the purpose of this article.

Figure 1: Profit Rate in the UK 1948-2010, Calculated in the Traditional Way³

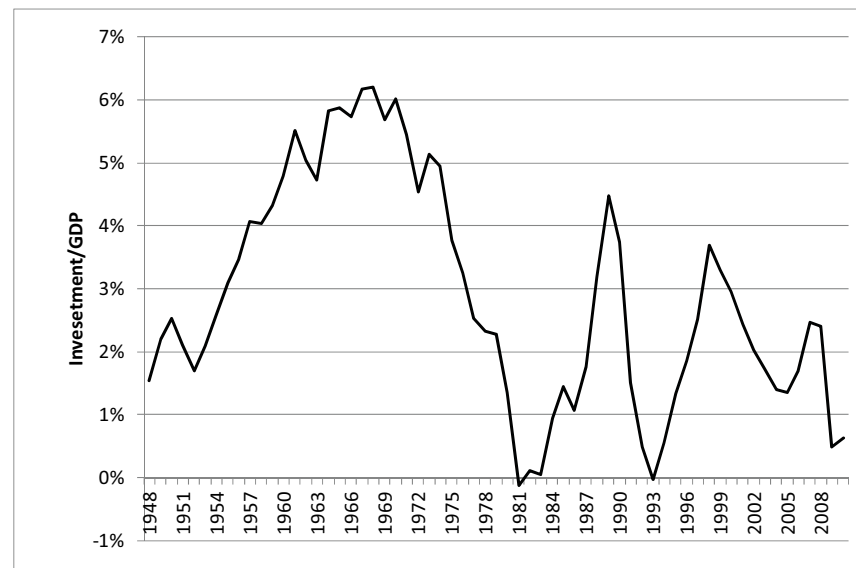


An Uncomfortable Fact about the UK Profit Rate

As Figure 1 shows, the UK rate of profit, as traditionally measured, reversed its postwar decline in 1974 and has thereafter risen ever since. The trend is extremely strong. Unless monetary assets are included in the denominator of the profit rate, as I propose, it shows up no matter how

the profit rate is measured or conceived. Unlike the US, there is no real room for dispute that it has risen systematically since 1976.

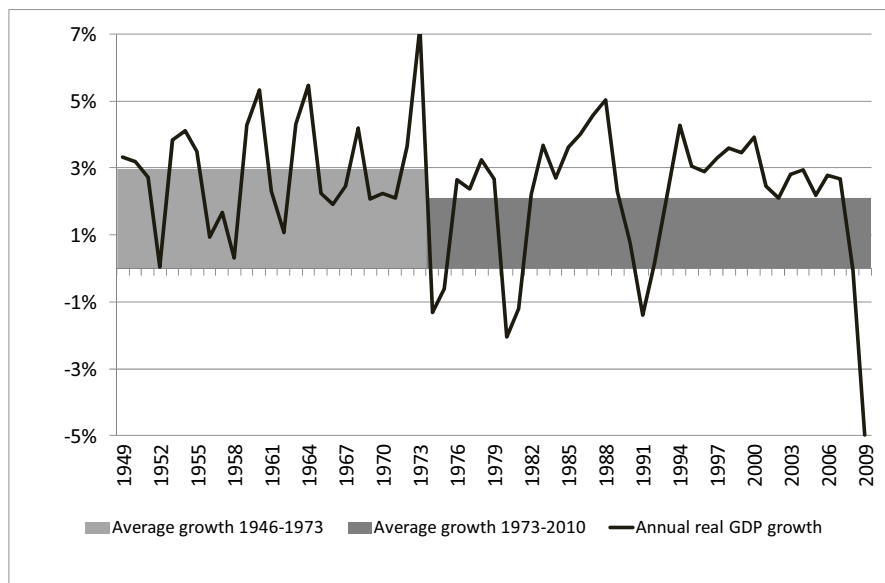
Figure 2: Net Investment in The UK as a Share of GDP 1948-2010



Yet almost all other indicators of economic performance suggest that the UK has declined, economically, more or less continuously or with minor interruptions, since the 1970s. Unemployment, which rarely rose above a million people until the 1970s, has not sunk below that level since then. The share of Net investment in GDP, shown in Figure 2, declined continuously from 1969 until 1981, when for the first time since the Second World War it became negative. It has since returned to near-zero twice, and from 1981 has not risen above 2% for any ten-year period, whilst between 1952 and 1981 it had never fallen below that level. GDP growth in the UK, shown in figure 3, until 1973 never fell below zero, yet it was negative in each of the following three recessions, and rarely exceeded the 3% average achieved between 1949 and 1973. How can this economic experience be squared with a continuous rise in the profit rate?

3 Sources for all figures are given in the data appendix at the end of this article.

Figure 3: Growth in Real GDP, UK 1948-2010



Commodity Capital, Fixed Capital, and Money Capital

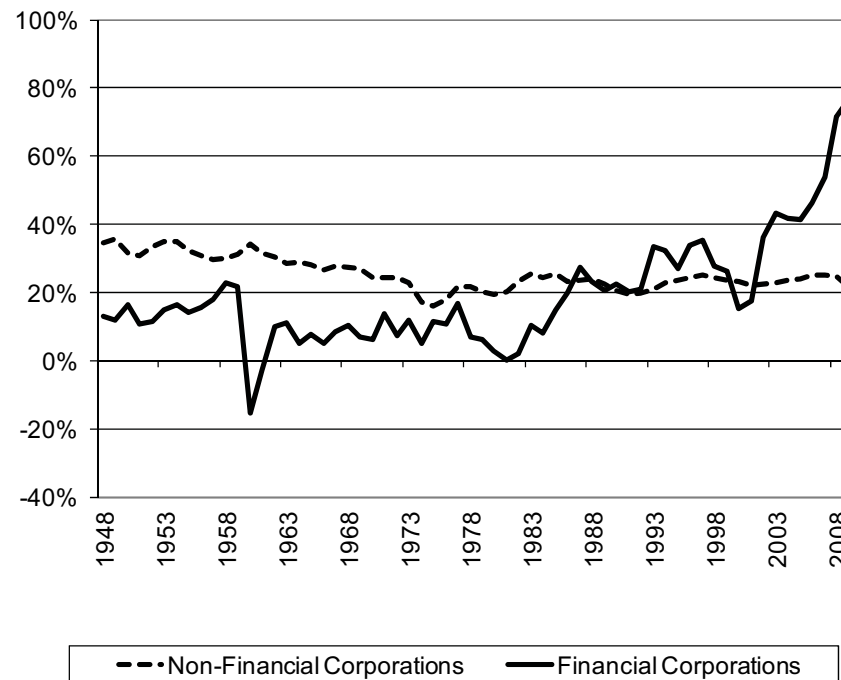
To resolve this anomaly we focus on the UK financial sector, in order to draw conclusions which apply across the board. As Figure 4 shows, the rate of profit for financial corporations, as conventionally calculated by Marxist writers, took off in 1980, having bumped along at around 10% for three decades, well below the profit rate for private non-financial corporations. By 1986 it had overtaken the profit rate for non-financial corporations and, after a blip in the 1999 recession, took off to stratospheric levels, reaching 80% by 2008.

What explains this disparity? Most commentators agree on one point: that financial firms do not produce value but appropriate it from value produced elsewhere⁴. They are in some sense not ‘normal capitalists’. This is true, but they do not function without capital. The unaddressed question is: what does this consist of? The answer is: *money* capital.

4 Moseley (1992), Mohun (1996, 1998), Shaikh and Tonak (1996).

Once this is recognised, the reason for the financial sector’s illusory stellar profit rate becomes clear. Any bank, whether commercial or otherwise, needs certain assets – buildings, computers, security vans, and so on – to conduct its business; these constitute ‘capital’ in the physicalist sense of something produced by labour, which is consumed when labour is applied to it. Some of these are not even tangible – for example software, now recognized as a capital expenditure on the valid accounting grounds that it provides services over a period of time, usually several years⁵.

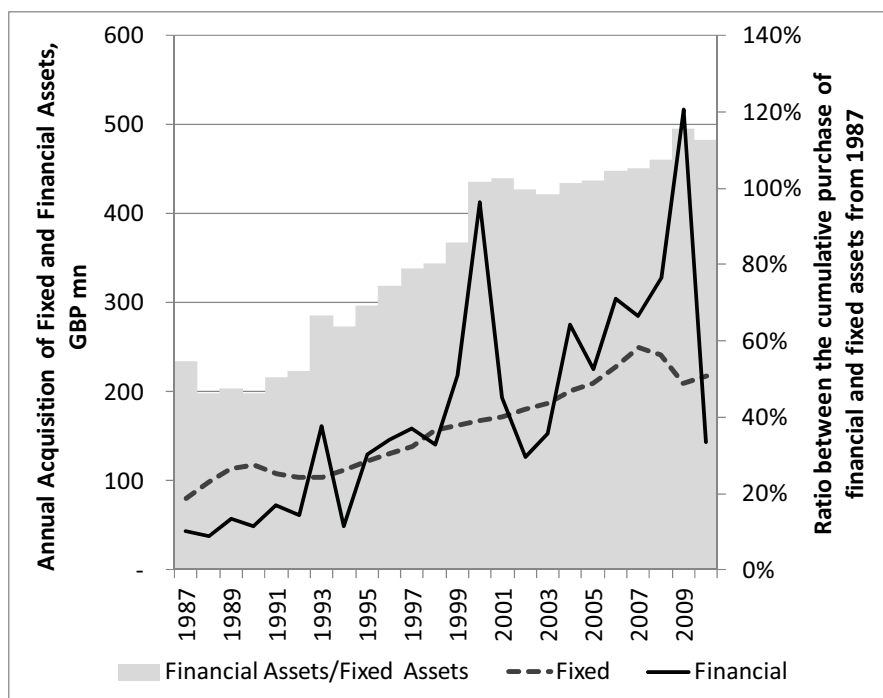
Figure 4: UK Profit Rate in the Financial and Non-Financial Sectors, 1948-2010



5 See Corrado *et al.* (2009), Gill and Haskel (2007).

But a bank's most important assets comprise sums of money, or marketable instruments exchangeable for money, which it accumulates in the course of its business. These may be reserves, metallic or currency; or they may be low-risk securities like T-bonds or riskier holdings whose number increased so greatly in the run-up to the 2008 crash. The key point is that the bank uses them to expand the value it can command. They are its capital. Consequently, they should be included in the denominator of its profit rate, and indeed, this exactly what the bank's accountants do.

Figure 5: Acquisition of Financial and Fixed Assets by the UK Corporate Sector 1987-2010



However, this is a perfectly general principle. It would be illogical and inconsistent to suppose that a monetary asset constitutes capital in the

hands of a bank, but ceases to do so in the hands of an oil company⁶. We therefore turn to the acquisition and ownership of financial assets by the corporate sector as a whole.

The UK accounts, unfortunately, only provide consistent data on monetary assets from 1987 onwards. But this is enough to establish the point: the UK corporate sector *as a whole* has been purchasing, and holding, such assets, at a rapidly accelerating rate as shown in figure 5. In 1987 it acquired £43bn in financial assets compared with £80bn in fixed assets. But after 1998, it acquired more financial than fixed assets in all but two years, so that its stock of financial assets has steadily grown compared to that of fixed assets. Between 1987 and 2008, net corporate sector acquisition of financial assets was 20% higher than of fixed assets.

In the hands of non-bank institutions such assets constitute capital just as much as when held by a bank. Indeed, as Enron shows, when financial assets are purchased on such a scale, many allegedly production-based firms become, in effect, mere financial holding companies. The coherent response is to treat all monetary financial assets as capital as long as they are in the hands of capitalists⁷.

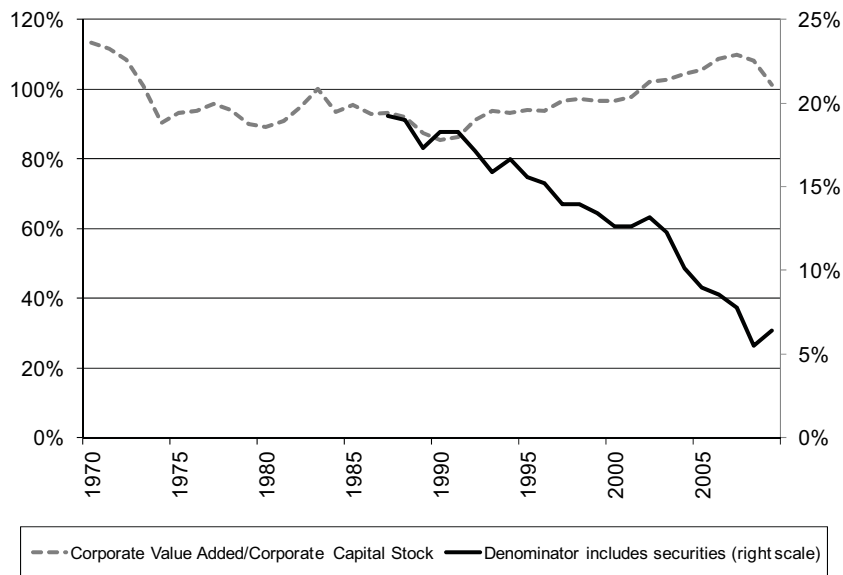
Figure 6 shows the effect of this correction on the profit rate. The longer segment, from 1970 to 2010, shows the traditional profit rate using fixed assets alone. The shorter segment, on a different scale, starts at 1987 when consistent data first become available. In it, the denominator of the profit rate includes medium- and long-run marketable assets.

The ONS's failure to provide consistent long-term data on UK financial assets prevents us from verifying how the corrected rate moved before 1987; however the trend since then is unequivocally and sharply downward, in contrast to the traditional measure and in conformity with the other measures of economic health we have cited.

6 In private correspondence, some reviewers have assumed that this article offers a theory of bank profits. This is not the case. Its purpose is to study monetary assets, which are routinely held by all capitalists. We begin with the banks because, in the immortal words of Willie Sutton, 'that's where the money is' – not in order to understand the banks, but what happens to their money when they let go of it.

7 In private correspondence, commentators have rightly pointed out that financial assets do not function as capital when owned by households. We refer only to financial assets owned by the corporate sector.

Figure 6: Corrected Profit Rate for the UK Economy 1970-2010



Two Clarifications

Before applying the same analysis to the US economy, two interim questions can be addressed.

Firstly, does the empirical evidence of a long term decline in the profit rate lead us to conclude that this tendential fall can never be reduced? Not at all. At definite moments in history this trend has sharply reversed, most recently from 1939-1948 when the US's entry into the war completely restored the profit rate and launched the postwar 'golden age' boom. There is strong evidence of a similar restoration after the first 'Great Depression' of 1873-1893 (see Freeman, 1998).

The problem (Freeman, 2010) is that capitalism's 'normal' functioning does not produce such restorations; they are the outcome of violent and disruptive actions by states and classes which suspend these 'normal' workings. This contradicts the idea popularised by Schumpeter (1939) that capitalism can recover from such deep crises as the Great

Depression, or the present crisis, by quasi-automatic mechanisms like those of the business cycle. However, such failures do not at all rule out the empirically evident fact that it can restore the profit rate by other means, such as war, conquest, or fascism.

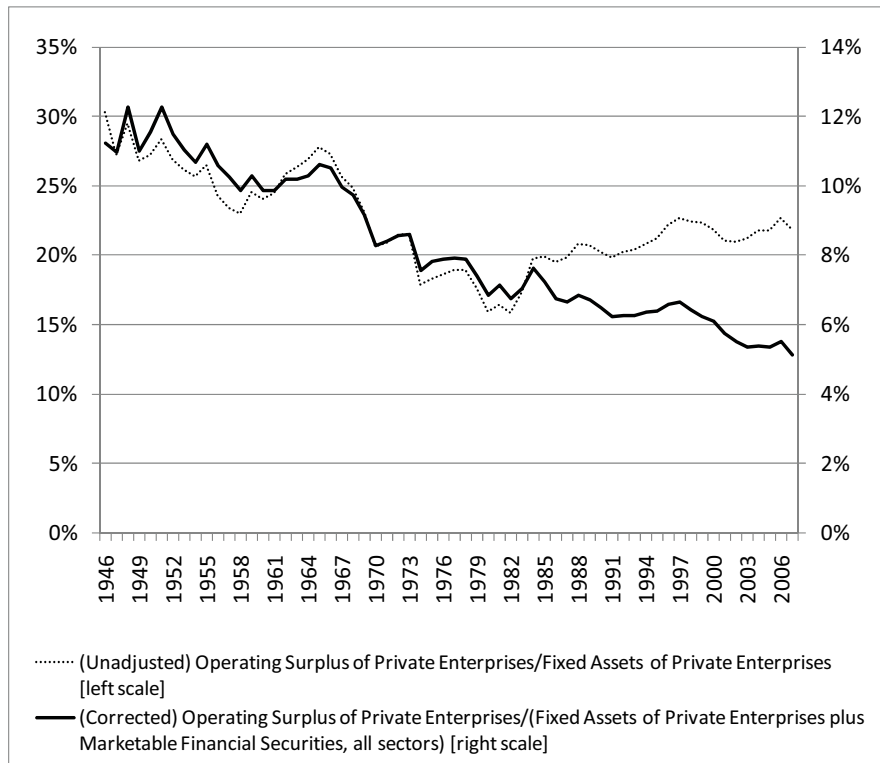
Secondly, could the profit rate have recovered were it not for financialisation, making the latter in some sense the 'cause' of the fall in the profit rate? Logic suggests otherwise: if capitalists do not accumulate financial assets, they must accumulate productive assets, or they cease to be capitalists. The denominator in the rate of profit would be just as high if they purchased machines instead of NINJA mortgages. If they chose financial instruments, it was because the already-falling profit rate had choked the range of profitable productive investments. If they had not done so, there is no reason to suppose the profit rate could thus recover.

The Profit Rate in the US Economy

Turning now to the US, data are available from the US flow of funds figures supplied by the federal reserve, dating back to the early 1950s, so a long-term picture is easier to obtain.

Figure 7 superimposes the traditional estimate of the profit rate on a corrected rate in which long and medium-term financial assets in the hands of the corporate sector are included in the denominator of the profit rate. This is a somewhat remarkable graph. The corrected rate parted company from the upward trend in the traditional rate precisely when the latter turned upwards in 1982, and continues downward at the same pace as the uncorrected rate before 1982. It closely tracked the traditional rate before 1982, which strongly suggests it is measuring a very similar thing up to that point⁸. It smooths out some of the volatility in the uncorrected rate before 1982. Finally, it shows a virtually uninterrupted downward trend since the high point of 1946. For those who set store by statistical correlations, the exponential trend $r=0.1235e^{-0.014t}$ predicts it with an R^2 of 0.9559.

8 If the corrected measure actually expressed something completely different from the traditional profit rate, we should not expect the close correlation seen between the two measures from 1946 to 1982.

Figure 7: The Profit Rate in the USA 1946-2006

We turn next to the theoretical foundation for this different way of understanding the rate of profit.

Credit Money and Credit-Money-Capital

Suppose first a capitalist has tied up \$1,000,000 of his own money in a factory which makes \$200,000 per year. His profit rate is 20%.

Now suppose next year the capitalist issues a bond yielding 10% for \$1,000,000 to a rentier. The manufacturer still owns the factory which is still worth \$1m, and the rentier owns a monetary instrument – the bond – which is also worth \$1m. Annually:

- The rentier receives \$100,000 from the manufacturer on an investment of \$1m;

- The manufacturer retains \$100,000 on fixed assets of \$1m.

What is the rate of profit, for now measured just over the two capitals concerned? The approach current among Marxist writers treats the interest as a kind of tax or levy which the law gives the rentier the right to exact:

- There are \$1,000,000 in ‘real’ assets in the economy yielding 20% as before;
- The manufacturer makes a deduction of \$100,000 from a ‘true profit’ of \$200,000 on fixed assets of \$1m;
- The manufacturer gives the rentier \$100,000 of this, being 10% of the bond’s face value; and the profit rate remains 20%.

As long as the industrialist has a purely private and personal relation with the rentier this presents no problems. However, what happens when there is a credit-money-market? The bond becomes a negotiable instrument, bought and sold alongside all other commodities. It functions as money, as Marx discusses at great length in Part V of Volume III of *Capital*.

But it then also becomes a commodity. It acquires a price; anyone with a sum of money has a choice and can invest it either in production, or in such interest-bearing assets. As the rate of profit falls, opportunities for profitable productive investment likewise fall: the purchase of interest-bearing assets becomes the most profitable alternative for growing numbers of capitalists.

Such money has become *idle*; in earlier times it would congeal as hoards of precious metals but, with the development of credit markets, it congeals as hoards of negotiable securities, for which it creates a demand. But where there is a demand, a supply emerges. And credit can be created without any of the limits imposed by material production, as the ingenuity of the investment bankers in recent decades has proven. Beside the productive capital tied up in fixed assets, a toxic slag-heap of income-bearing instruments rears up.

It is neither plausible nor informative to deny that this constitutes capital: *credit-money-capital*. It is capital of a special kind, being unconstrained by any natural limit on how much of it can be produced. Provided the bankers are allowed to get away with it, they can simply declare it into existence. An alternative account is as follows:

- There is \$2,000,000 in capital in the economy, being the \$1,000,000 in fixed assets, plus the (unsecured) bond with face

value \$1,000,000 issued by the owner of these fixed assets, each yielding 10%;

- The manufacturer makes \$100,000 on fixed assets of \$1m;
- The bond's owner makes \$100,000 on monetary assets of \$1m.

To grasp the significance of this presentation it is important to understand how credit-money-capital differs from commodity capital. Above, we assumed that the rentier's money came from the industrialist, but this is by no means necessarily what happens. In the recent explosion of financial assets, any and all debts have been capitalized – not only the infamous NINJA mortgages but government debt, derivatives and direct fraud have created all manner of instruments which no longer rely on directly appropriating industrialists' income. My central point is that the *origin* of this income is not relevant to whether, when capitalised, it functions as capital. The criterion is simple: do capitalists acquire it and hold onto it, and does their capital thereby grow?

The second presentation, I argue, provides a truer account of this new situation. Unlike the first, it remains valid when the bond does not originate with the industrialist but in some other debt instrument. In fact it generalises to any instrument that attracts a stream of revenue, whether this is a debt instrument, a land title, or an equity.

This emphasizes that it is probably fruitless to look for 'diversions' of *revenue* from the purchase of real assets as the cause of US and UK difficulties. This is the problem I have with the account provided by writers like Shaikh (2011) who emphasise the *costs* of the financial sector, either explicit (interest payments) or implicit (the disguised burden of unproductive labour) to the industrialists.

It also explains Kliman's (2011) finding that capital investment correlates strongly with the profit rate, which contradicts the idea that the financial sector operates to divert revenue from investment to other uses. First, it is not the financial *sector* which is the problem. It is *finance*, of which all capitalists avail themselves as a substitute for productive investment. Second, finance does not divert revenue: it diverts capital. In the last analysis, financial instruments are merely a form of idle money: an ever-growing portion of social capital is not engaged in productive activity but accumulates as a hoard of parasitic titles.

The problem is not that investors have insufficient money to invest, but that the money-markets offer them other things to do with it. This brought about, for example, the Enron phenomenon: far from being

dragged to ruin by exorbitant bankers, industrialists outdid the bankers themselves in substituting speculation for production. In general, capital – not revenue – has flowed out of industry into finance.

No cost is directly associated with creating credit-capital because it is not a produced commodity. The real problem lies elsewhere. Society exacts a final revenge. Credit instruments can only draw their returns from a pool of income – new value – which is fixed not by the imagination of the bankers but by the labour-time at society's disposal. This shows up directly in diminishing average returns to all social capital, and ultimately in great crashes in which the prices of all non-value-based assets collapses, as it becomes clear how little is to be gained from robbing empty houses.

One puzzle remains. Surely, as Marx points out, these fictitious capital sums are merely double-counted representations of an underlying value: 'the capital value of this security is still pure illusion' (Marx, 1981: 597). The additional capital created by the financiers does not constitute additional value, only additional money. How can it be, therefore, that capital is in any sense 'bound up' in these instruments? The solution is provided by the brilliant exegesis of Marx's theory of money offered by Alejandro Ramos (2007) and generally accepted by TSSI scholars. For Marx, money represents value by virtue of representing it in exchange. If the capitalists in a country own \$10,000,000 in fixed assets, produced by a million hours of labour, and if they have also salted away \$10,000,000 in money, then the million hours of labour are *represented in* \$20,000,000. Each hour therefore has a *monetary expression* (MELT) of \$2. The capital of society, therefore, when we consider its capacity to purchase or produce other goods, is divided into two parts: that represented by the price of the fixed assets, and that represented by the money. Since the total value remains unchanged, the presence of the idle money devalues the fixed assets *pro tanto*.

TSSI scholars already accept that when circulating constant capital is consumed in production, the value that it transmits to the product is the value that it *represents* in exchange, not the value embodied in it. This insight is critical to resolving the alleged, but non-existent, 'inconsistencies' in Marx's transformation procedure. A fully consistent treatment requires that fixed capital (which is merely another form of constant capital, consumed over a longer period) be treated in exactly the same way. Consequently, it is the value *represented in exchange* by the

capital assets of society that should be included in the denominator of the rate of profit – including monetary assets.

In ‘normal’ times, money is a small proportion of the capital of society; and no great empirical error arises if we treat the capital value of fixed assets as simply equal to the labour that produced them. But the past four decades have seen an enormous growth of financial assets – in the last analysis, no more than a giant hoard of idle money – which have rendered this simple reduction empirically inaccurate, thereby revealing its theoretical inadequacy. This quantitative change has now attained a qualitative dimension. In the process it has *devalued* the fixed assets which are being replaced by financial assets as targets of investment.

This surfaces in a universal asset-inflation. The same amount of value is expressed in larger and larger sums of money. The appearance that this credit-mountain is a cornucopia of income growing at the same rate as the mountain, comes crashing down when it becomes clear that the promises to pay cannot be honoured – and the result is a crash.

In summary, such phenomena should not be treated as something separate from the general decline in the rate of profit because they are a product of it, and indeed a morbid form of it. They are part of the *same* process, beginning at the end of the late 1970s, which as Desai (2013) explains, produced the systematic decline of the US and UK, dragging the world with it until the rise of China and the hammer-blows of the crash.

When this correction is made, many things that previously seemed senseless, make sense once again, including above all the central paradox of traditional Marxist theory, which has now reached the untenable *impasse* of declaring high profits to be the primary cause of crisis. That is why I consider this change a superior theoretical innovation. However, one innovation does not make a theory. To complete our argument we turn to the body of theoretical knowledge within which this one idea sits, namely Marx’s theory of value.

Money Capital

Marx opens Part V of Volume III of *Capital*, which deals with interest-bearing capital, with the following words:

On our first consideration of the general or average rate of profit (Part Two of this volume) we did not yet have this rate before us in its finished form, since the equalization that produced it still appeared simply as an equalization of the industrial capitals applied in different spheres. This was supplemented in Part Four, where we discussed the participation of commercial capital in this equalization, and commercial profit.... In the further course of our analysis it should be borne in mind that when we speak of the general rate of profit or the average profit from now on, this is in the latter sense, i.e. always with respect to the finished form of the average rate ... whether capital is invested industrially in the sphere of production, or commercially in that of circulation, it yields the same annual profit in proportion to its size (Marx, 1981: 459).

This passage, although it opens the largest section in Volume III, has not received enough attention. The ‘finished form’ of the profit rate is not that which *excludes* commercial, financial, and landed capital, but to the contrary, significantly modifies the inadequate notion we might have, if we confined ourselves only to productive industry.

It is because the general rate of profit is not confined to industrial capital that merchant’s capital yields a profit without creating any new value: it appropriates value produced elsewhere. It performs for capital a necessary specialist function by reducing the time of circulation, and its margins and hence profits are driven downwards by capital inflows and upwards by capital outflows.

This same reasoning yields Marx’s category of *absolute rent*. Against Ricardo, he argues that land yields a rent at least equal to the average rate of profit even if all other land outperforms it:

If the market price of the product, say corn, reaches such a level that an additional advance of capital invested in class A [the poorest – AF] land pays the customary price of production, i.e. yields the customary average profit on the capital, this condition is sufficient for the investment of additional capital on class A land (Marx, 1981: 883).

Merchants and landowners can appropriate value produced elsewhere, in short, because their capital participates in the equalisation of the profit rate. They get their income, and thereby form distinct social classes, because they own a special kind of capital which performs special and

necessary functions for other capitalists. But in consequence they offer *alternative uses for capital*; any sum of money can be invested in a trading venture instead of a factory. Any neoclassical textbook informs us the choice of use is driven by the search for the greatest return. Marx's more subtle reasoning, closer to Keynes's concept of the marginal efficiency of capital, yields the same conclusion: whenever a profit rate differential exists, capital migrates from uses yielding lower rates to those yielding higher rates. Supply rises, and prices fall, where rates are high, and *vice versa* where they are low: prices react, decreasing the divergence between these rates of return.

The competition between capitalists – which is itself this movement of equalization – consists in their withdrawing capital bit by bit from those spheres where profit is below the average for a long period, and similarly injecting it bit by bit into spheres where it is above this (Marx, 1981: 488-489).

Once other forms of capital – commercial, banking and landed – enter into the equalization process they become alternative locations for these 'bit by bit' injections of capital, and depress the average rate of return across the all social capital.

Elusive Illusion: Fictitious, Real and Money Capital

To clarify this point we turn to 'fictitious capital', arguably the most abused of Marx's multiply-misrepresented categories. Fictitious capital is neither non-existent, nor fraudulent. It is not even useless. Marx begins his treatment of money capital by insisting that this has a use-value when it functions as capital:

On the basis of capitalist production, money ... enables the capitalist to extract and appropriate for himself a certain quantity of unpaid labour, surplus product and surplus-value. In this way the money receives, besides the use-value that it possesses as money, an additional use-value, namely the ability to function as capital.... In this capacity of potential capital, as a means to the production of profit, it becomes a commodity, but a commodity of a special kind (Marx, 1981: 459-460).

Fictitious capital is not specifically fraudulent. Speaking of shares 'in railway, mining, shipping companies, etc.' under the general heading of 'fictitious capital', Marx notes that:

It is in no way ruled out that these shares may simply be a fraud. But the capital does not exist twice over, once as the capital value of the ownership titles, the shares, and then again as the capital actually invested in or to be invested in the enterprises in question. It exists only in the latter form, and the share is nothing but an ownership title, pro rata, to the surplus-value which this capital is to realize (Marx, 1981: 597).

Though fraud 'is in no way ruled out' it is not constitutive. Marx uses the term 'fictitious', sometimes interchangeably with 'illusory', for a different purpose: to describe capital that *appears* to produce value but is actually only a claim on value produced elsewhere. Its price is independent of its value – most fictitious capital does not even have a value – and is fixed by mechanisms specific to its title to future income:

The formation of fictitious capital is known as capitalization. Any regular periodic income can be capitalized by reckoning it up, on the basis of the average rate of interest, as the sum that a capital lent out at this interest rate would yield.... In this way, all connection with the actual process of capital's valorization is lost.... Even when the promissory note – the security – does not represent a purely illusory capital, as it does in the case of the national debts, the capital value of this security is still pure illusion (Marx, 1981: 597).

The term 'fictitious' is thus applied to diverse instruments ranging from land titles to equities to bonds and even bills. There is an underlying unity: a fictitious asset is one whose *value is not the foundation of its price*. This does not mean it does not exist, or counts for nothing. It counts for a great deal because, having a price, it represents an exchangeable claim on real value. It can be exchanged for notes, and used to buy things that most definitely do have value. Fictitious capital is a claim on *somebody else's* value, the nature of the claim depending on source of the value. Titles to land are a claim on rent; government bonds a claim on tax revenue; equities a claim on directly-produced surplus-value, and so on. The process of securitisation seizes on the unity, not the difference, converting all claims on income to their common denominator: credit. Credit-capital is hence a *specific form of fictitious*

capital, but its most developed, and most natural one. To understand how it enters the equalisation of the profit rate, we should study this specific nature.

Money capital is a form of money. It is a loan, an entitlement to use money to make surplus value. It alienates a particular use-value of the money (the right to make purchases with it) without alienating the money itself, of which the lender retains ownership:

The sum of value, the money, is given out without an equivalent and returned after a certain period of time. The lender remains the owner of this value throughout, even after it has been transferred from him to the borrower (Marx, 1981: 474).

It thus enters the equalisation process differently from commercial and landed capital because it is not exchanged with anything. Its price – interest – is therefore determined without any reference to production at all – by ‘supply and demand’:

If supply and demand coincide, the market price of the commodity corresponds to its price of production; i.e. its price is then governed by the inner laws of capitalist production, independent of competition.... It is different, though, with interest on money capital. Here competition does not determine divergences from the law, for there is no law of distribution other than that dictated by competition; as we shall go on to see, there is no ‘natural rate of interest’. What is called the natural rate of interest simply means the rate established by free competition. There are no ‘natural’ limits on the interest rate (Marx, 1981: 477-478).

This is peculiar to money-capital: the return on a loan shows no tendency to be equalised. It may rise sharply higher than the profit rate, as in a credit crunch, or fall well below, as during the early stages of a boom. Interest has no necessary relation to profit above and beyond the fact that total (net) interest, that is the income which actually finishes up in the hands of the rentiers after finishing its merry-go-round, must always be less than surplus value. Surplus-value is therefore an ‘upper limit’ to interest, as Marx puts it. Beyond this, ‘there are no “natural laws”’.

Fictitious capital thus *remains a form of capital*. It is part of what is advanced so that value may expand, and constitutes a claim on the total surplus value that this advanced capital yields in production. It therefore

enters into the formation of the rate of profit and, as such, must be accounted for when the denominator of that rate is calculated.

Conclusion

Let us now bring these threads together. Marx develops his analysis of both commercial capital and landed property through a discussion of what he terms the ‘finished form of the average rate’ (*op. cit.*). The decisive feature of this finished form is that non-industrial capitals compete, within it, for a share of the total surplus value originating in production. It clearly therefore includes non-industrial capitals; and all that remains unclear is whether, and to what extent, the return to money-capital should be placed on the same footing as commercial profit and absolute rent. There are many forms of money-capital and the specific form of money-capital in question is credit-money: money or quasi-money arising from the securitization of debts.

There are many sound theoretical reasons for treating credit-money-capital on an equal footing with commercial and landed capital, of which the strongest is the simple fact that once any title is alienable and can be purchased on the market, it offers, *de facto*, an alternative employment of money. There are two theoretical differences. The first is that little or no commodity capital is present in credit-money. In the case of land, at least when used for crop production, the return is anchored to the whole circuit of capital; if for example the crops are not sold, the rent will fail, if for no other reason than that the farmer goes bankrupt. Commercial capital is likewise tied to the values that pass through its hands. For this reason, neither of these forms of capital can expand ‘without limit’ – without being affected by whether the values that they handle are realised. This is not so for credit-money. There are eventual, final limits on its expansion which are reached in great crashes, but much larger quantities of money can be poured into it, and much longer bubbles sustained, before the moment of reckoning.

The second is that the return on credit-money-capital, unlike the return on commerce or to a lesser extent land, depends on no underlying value. The creditor does not exchange the use of his or her money for anything, and in fact does not even part with it, offering merely the temporary use

of it in return for an income⁹. The industrialist remains the owner of the productive assets purchased with the credit and the entire burden of ensuring this value is realised, falling on him and him alone. The creditor merely asks for his pound of flesh: 'I will have my bond' is voided of all personal affect in the modern debt relation, which allows entire countries to sink into starvation and ruin rather than deny the bondholder, with no latter-day Portia to hand to administer pre-capitalist mercy. Of course, in the end, the pound of flesh is not forthcoming since the industrialist has none left to give; but this moment is postponed to the hour of the crash.

Neither of these reasons seem to me to override the fundamental point, which brings us back to the financialised economies of the early twenty-first century: once credit becomes a marketable instrument it competes with all other uses of capital for a share of surplus value, and therefore bears down on the profit rate every bit as much as commerce, landownership, or industrial production. The differences inform us only that this is a very peculiar and special *kind* of claim on surplus value, one on whose voracity the market sets no limits. For this reason the correction seems to me fully valid, consistent with Marx, and worthy of much more systematic attention than the Marxists, or anybody else for that matter, has so far paid it.

One final point has to be made. Many of those who have kindly commented on my article, when in draft, have taken issue with this or that aspect of my proposed correction: for example the inclusion of equities, or the omission of non-credit-money. There is doubtless room for improvement. But given the seriousness of the theoretical issues, and the sheer magnitude of the empirical differences, it is not reasonable to *ignore* the need for a correction. It is now incumbent on those who do not accept my procedure, therefore, to propose their own alternatives. If this article provokes them to do so, it will have succeeded.

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9 'The sum of value, the money, is given out without an equivalent and returned after a certain period of time. The lender remains the owner of this value throughout, even after it has been transferred from him to the borrower' (Marx 1981:474).

Data Appendix

All magnitudes in current national currency prices unless otherwise stated. UK figures refer to the UK Blue book; US figures to the NIPA and flow of funds accounts.

Figure 1

$$\text{Profit Rate} = (\text{NQBE} + \text{NQNV}) / (\text{CIXH} + \text{CIXI})$$

NQBE= Gross Operating Surplus of the Non-Financial Corporations

NQNV=Gross Operating Surplus of the Financial corporations

CIXH= Fixed assets of the nonfinancial corporations

CIXI = Fixed assets of the financial corporations

Figure 2

$$\text{Non-residential investment as a share of GDP} = \text{NPQX} - \text{NQAE} - \text{DFDK} / \text{YBHA}$$

NPQX=Gross Fixed Capital Formation

DFDK=New Housing

YBHA=GDP

Figure 3

$$\text{Real GDP} = \text{YBMA}$$

Figure 4

$$\text{Financial Sector Profit Rate} = \text{NQNV} / \text{CIXI}$$

$$\text{Non-Financial Sector Profit Rate} = \text{NQBE} / \text{CIXH}$$

Figure 5

$$\text{Financial Assets} = \text{NQAP} + \text{NQAL}$$

NQAP = net acquisition of equities in the UK

NQAL = net acquisition of securities other than equities, in the UK

Fixed Assets = NPQX

NPQX=Gross Fixed Capital Formation in the UK

Figure 6

$$\text{Uncorrected rate} = (\text{QTOP} + \text{QTPK} + \text{QTPL} + \text{QTPZ}) / (\text{CIXH} + \text{CIXI})$$

$$\text{Corrected rate} = (\text{YBHA} - \text{QTPS}) / (\text{CIXH} + \text{CIXI} + \text{NLIZ})$$

QTPS = value added, letting services

NLIZ=Financial Derivatives, investment position, all sectors

Figure 7

Fixed Assets= Non-residential capital stock of private enterprises, from BEA capital stocks table 1.1 line 15; Operating Surplus=Operating Surplus of Private enterprises, from NIPA table 1.10, line 12; Marketable Financial Securities=Federal Reserve Flow of Funds item FL894104005 (year end) 'All sectors: credit market instruments'

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