make vast profits from these deals. For example, the British mobile phone company Orange has changed ownership so many times that the fees generated for the banks and advisors involved have exceeded the company's historic revenues (Chancellor 2001a; 2001b). Once the buying and selling of corporations reaches a certain momentum, any given company is increasingly forced to participate either to pre-empt being acquired or in order to compete with any newly merged rivals. In many ways, this transformation of the enterprise itself into a marketable commodity expresses the very essence of capitalism – that is, the ultimate subordination of all economic activity to the power of pure money-capital.

Capital and financial markets

Private property and wage-labour were present to some extent in earlier economic systems, but, as I have emphasized, the financing of production by capital markets and the existence of large-scale speculative markets in financial assets are specific to capitalism (Schumpeter 1994 [1934]: 78). Both activities are made possible on a large scale by the supply of credit-money – that is to say, the ready availability of bank created 'money-capital' by which capitalism is distinguished from other types of economy.

Over the last twenty-five years or so financial sectors have grown considerably in relation to the rest of the economy at both national and global levels. Since the 1970s the US stockmarket valuation of financial corporations has increased from less than 10 to almost 30 per cent of the valuation of non-financial corporations. Over the same period, aggregate financial corporations' profits in the USA have grown from around 20 to over 50 per cent of those of non-financial corporations (Glyn 2006: 52). In the twenty-five years between 1980 and 2005, the stock of global financial assets grew from 139 per cent ($10 billion) to 316 per cent ($140 billion) of global GDP, prompting discussion of 'financialization' as a new stage of capitalism (Glyn 2006; Krippner 2003; Epstein 2005; Erturk et al. 2008; Wolf 2007; Morris 2008; see also Blackburn 2006).
This expansion of the financial sector has been accompanied by a bewilderingly arcane complexity. Even participants struggle to comprehend the astonishing proliferation of specialized markets by which money is mutated, by what is known as ‘financial engineering’, into a complex array of ever-changing tradable financial assets and instruments. It is no longer simply a matter of stocks and shares, but also futures, options, ‘swaptions’, credit-default-swaps, derivatives and so on (for an accessible survey see Valdez 2003). The important ‘derivatives’ markets will be examined later; here we might briefly note that they are essentially forms of organized speculative gambling on price changes. The ‘derived’ financial asset is a contract (or wager) between two parties that the price of a commodity or asset (for example, copper or the dollar–euro exchange rate) at time x will be $y. The contracts are also traded; that is, they are bought and sold by third parties. Profits and losses are the result of the divergence, at the designated time, between the derivative contract price and the actual price of the commodity or asset from which it is ‘derived’.

In attempting to unravel the complexities of modern capitalism’s financial system, it is helpful to distinguish between ‘money’, ‘capital’ and ‘financial’ markets. The money market, as discussed in chapter 4, comprises the institutional creditor–debtor links between the state, the central bank and the banking system which coordinate the supply and demand for money — that is, a means of payment denominated in a money of account. This is the fundamental source of the money that fuels capitalism. The capital market comprises the institutions and organizations — stock markets, investment banks and so on — for transforming this supply of money into money-capital to meet the demand from producers for the financing of the production of goods and services. These are the primary markets in the sense that they are the basic means for generating the fundamental supply of money-capital for enterprise — that is, with the supply of the first ‘M’ stage in Marx’s (M)oney → (C)ommodity → (M)oney, notation of the capitalist process.

As we have already noted, there are two main ways in which ‘primary’ money-capital for enterprise can be raised — by stocks and shares (equities) or debt in the form of bank loans and bonds on which interest is paid. Owners of stocks and shares receive revenues in the form of a ‘dividend’ from the ‘share’ of the enterprise surplus. In addition, as we shall see below, they may look for a profit from selling stock if the price on the secondary stock market increases. In this way, as we have noted, stock markets also transform the enterprise itself into a tradable commodity. By bidding for shares, it is possible to gain control of an enterprise even against the wishes of the incumbent management and directors — that is to say, by means of a ‘hostile takeover’ carried out, for example, by ‘corporate raiders’ and ‘private equity’ groups.

Money-capital can also be raised directly by a bank loan at a rate of interest that varies according to market conditions and the credit rating of the borrower. (However, as we saw in chapter 4, the rate of interest in modern capitalism is ultimately dictated by the rate at which the banks can borrow from the central bank to finance lending and balance their books.) Enterprises can also raise capital by the issue of debt in the form of a bond which specifies the date of repayment and usually fixes the rate of interest to be paid during the term of the loan. The increasing plasticity of fungible forms of money-capital in modern capitalism is apparent in the way in which enterprises can now raise capital by ‘securitizing’ their prospective revenue or profits. Money is raised by selling the enterprise’s future income — for example, a relatively dependable projected revenue stream such as rents, interest payments on mortgages — as a ‘security’. This form of finance has grown dramatically; for example, between 1998 and 2006 securitization issuance in Europe alone increased from 30 to 450 billion euros (Financial Times, 16 August 2007). (As we shall see, the securitization of US ‘subprime mortgages led to the global financial crisis during summer 2007.)

It has been suggested that such methods of raising finance have reduced the role of bank lending as the powerhouse of the capitalist system. Whilst it is true to say that direct lending as a primary source of finance might have declined relative to these alternative forms (for example, ‘securitization’), it is entirely misleading to construe this as the ‘death of banking’ (Stearns and Mizruchi 2005). In the first place,
the purchase of 'securitized' assets and other alternative finance is made with bank loans. But, more importantly, the banks' privileged access to central bank money - the ultimate source of the means of payment by which debts are settled - maintains their pivotal position. Central banks' links with their banking systems are the bedrock of capitalism. At times of financial crisis, money - that is, 'liquidity' - can be pumped into the banking system by central banks, as 'lenders of last resort', to prevent the total disintegration of the credit networks that hold the capitalist system together. This occurred in 2007 when the collapse of the UK mortgage bank, Northern Rock, was prevented with loans of over £30 billion that were underwritten by the UK Treasury (see pp. 167-9).

As we noted in the previous chapter, capitalist economies have varied quite considerably in the relative mix of stock-market (equity) and bank (debt) finance. One group of economies - comprising the USA, the UK, and those countries that were part of the British Empire - rely largely on the stock market. In contrast, continental European capitalist economies and late starters such as Japan use bank loans to a greater extent. The two modes of finance are, as we have seen, related to different enterprise structures of ownership and control and, consequently, different configurations of the struggle for its surplus between owners and incumbent managers.

As I have emphasized, it is a definitive characteristic of capitalism that all property, including raw materials, money-capital and physical capital, has a dual character - as a means of production and as a marketable 'financial' asset. Secondary markets are those in which these financial assets are traded with a view to making profits, not through the production and sale of goods and services, but from speculation on anticipated changes over time in the price of the asset - that is, (M)oney → (M)oney, or the trading of pure exchange values. Profits can also be made by exploiting price differences between spatially separate markets - that is, by arbitrage. In 1995 the trader Nick Leeson famously brought down London's old elite investment bank Baring Brothers with the losses on his arbitrage trades between the Tokyo and Singapore foreign exchange markets.

Routinely, the shared expectations and strategies of the market participants in these secondary markets - arbitrages and speculators - maintain relatively stable prices for financial assets. However, speculative 'bubbles', in which large and rapid price rises are followed by precipitous falls, are an inherent and frequent feature of secondary financial markets in capitalism. Early financial crises in which asset prices inflated into 'bubbles' which then burst occurred in the Dutch Tulip Mania of 1637, London's South Sea Bubble in 1720, and the Hamburg commodity price crash of 1799. Crises occurred every decade or so throughout the nineteenth century and as capitalism expanded and extended its global reach - 1907, 1929, 1974, 1987, 1990, 2001 and 2007 (see Mandleberger and Aliber 2005). The common denominator in all crises is the fact that 'bubbles' can only occur if easily available credit-money can be produced by a banking system. Crashes and panic occur when, for whatever reason, prices begin to fall and assets are sold to repay the debts that fuelled the speculation and to avoid further losses. As we have already noted, at this juncture central banks frequently step in to provide loans to the major banks in an attempt to keep the system intact.

Orthodox economic theory's 'efficient market hypothesis' maintains that the two markets - 'primary' for financing production and 'secondary' in speculative assets - are functionally integrated in a way that maximizes the efficient allocation of capital. First, on the assumptions of perfect information, perfect competition and rationality, it is argued that share prices in the secondary market accurately represent the prospective profitability of the enterprise (see the discussion of perfect competition in chapter 5). Thus money is drawn towards successful companies, driving up their share price and increasing their capital. Conversely, a falling share price acts as a spur to improve performance. In this conception of the capital and financial markets, 'bubbles' that disturb this orderly process are attributed to unexplained psychological traits - for example, 'irrational exuberance', Alan Greenspan, the charismatic chairman of the US Federal Reserve, famously put it during the 1990s 'dot.com' boom (see Shiller 2000; Pixley 2004). However, as we have seen, both Keynes and Minsky argued that speculative
bubbles were an inherent consequence of the normal functioning of capitalism. Secondary speculative capital markets are made possible by uncertainty— that is, the absence of perfect information about an enterprise’s future profits. Thus, as Keynes argued, capital markets have an inherent tendency to become unproductive ‘casinos’, diverting capital from enterprise and creating unnecessary price volatility and ‘bubbles’.

Second, the ‘efficient market hypothesis’ implies that competition between capital market intermediaries—investment bankers, brokers, securities traders and so on—keeps their profits at a level that represents no more than their functional contribution to the process by which savings (money) is transformed into (money-)capital for productive enterprise. If brokers and investment bankers were to extract too much in the way of fees and commissions, they would be undercut—as the deregulation of the stock markets in the ‘big bangs’ of the 1970s and 1980s intended. However, as we shall see, the actual structure of today’s capital and financial markets does not conform to this model; rather, they are dominated by an oligopoly of investment banks which are able to use their power to control opportunities for profit in ways that some would suggest impair efficiency in the supply of capital (Augar 2006; Chancellor 2001a; 2001b).

Third, as we shall see shortly, modern economics’ finance theory also argues that futures and other derivatives markets harness speculation with ‘hedging’, which creates price stability and, therefore, performs a positive function for the economy.

In what follows these general issues will be pursued in discussions of three important features of today’s capital and financial markets: the stock market and the investment bank oligopoly; the new financial developments of ‘hedge funds’ and ‘derivatives’ markets; and a further examination of the buying and selling of the corporation in the mergers and acquisitions market. Finally, we shall take a brief look at the case of Enron’s rise and fall as an example of how these new financial markets have become closely entwined in modern capitalism with the large business enterprise.

Stock markets and the investment bank oligopoly

Since the early development of markets for government shares in the early eighteenth century, stock markets have undoubtedly become one of society’s most effective economic institutions for channelling finance into productive enterprise. But throughout the history of capitalism it has been persuasively argued that bankers, stock brokers and share dealers are simply economic theory’s ‘neutral intermediaries’ for the coordination of the supply and demand for capital. Since their appearance on the capitalist scene, it has been alleged that their position gives them the power to manipulate the market to their advantage (for a penetrating sociological analysis of the early-eighteenth-century London stock market, Carruthers 1996; for a sociological study of Wall Street in the late twentieth century see Abolafia 1996).

There are two sources of profit-making for stock market intermediaries. First, stockbrokers and dealers charge commissions on the purchase and sale of stocks for clients—today, for example, the ‘fund managers’ of the large insurance and pension funds. Second, investment banks can trade stocks and shares on their own account. These activities present the obvious potential for market manipulation. For example, dealers might buy shares cheaply, promote them and ramp the price, or use information on imminent price changes that is not available to the public. In order to maintain trust in the markets, regulations and conventions have been developed to prevent such manipulation by the ‘insiders’. However, the stock market ‘deregulation’ during the 1980s and the growth of investment banks which combine the whole range of financial activities, including stock and share trading on their own account, would appear to have weakened these controls.

At the first place, as we shall see, dealers and investment banks are in a position to encourage and stimulate a high turnover of stocks and shares (‘churning’) in the secondary market purely for their own advantage, regardless of the economy’s demand for primary capital (see Augar 2006). Since the 1960s the rate at which the US financial
fund, in pursuit of short-term speculative gains, turns over (or ‘churns’) its entire portfolio has increased from once every five years to once a year (Financial Times, 18 October 2006).

‘Insider trading’ involves the use of privileged information – for example, the impending news of a takeover bid, or the declaration of an increased profits by a firm – by the market intermediaries to purchase shares, on their own account or through an accomplice, before they rise in price. Intentional ‘insider trading’ is universally prohibited, but for obvious reasons the regulatory authorities, on the ‘outside’, find it difficult to monitor and control. Britain’s Financial Services Authority estimates that ‘insider trading’ is present in over 30 per cent of transactions on the London Stock Exchange (Dubow and Monteiro 2006). Such manipulation of the stock market has been a ubiquitous feature of capitalism, especially during investment booms when there is the greatest opportunity for profit-making – for example, in the South Sea Company ‘bubble’ of 1720, in the USA during the 1920s and again in the late 1990s ‘dot.com’ and ‘new economy’ bubble. Throughout the history of capitalism, the periodic public disclosure of opportunistic predatory manipulation of the financial markets has led to a serious loss of legitimacy of the capitalist system and has invariably set in motion a process of investigation and legislative re-regulation to repair the damage.

In his post-mortem on the 1929 Wall Street Crash, the lawyer Ferdinand Pecora discovered how the oligopoly of Wall Street banks had cooperated to their mutual advantage by ramping up the price of particular stocks (Chancellor 2001a; 2001b). Targeted stocks would be bought at a low price and then recommended by word of mouth and in the Wall Street Journal, raising their price and creating a profit for the banks. In addition, JPMorgan, for example, distributed stocks at below market prices to persons on its ‘preferred list’, including the former president Calvin Coolidge. Pecora’s investigations led to the 1930s New Deal legislation which set up the Securities and Exchange Commission to regulate the capital market.

The investigation by the New York State attorney general, Eliot Spitzer, into the late 1990s information technology boom and crash revealed similar market manipulation (Augar 2006). Investment banks and brokers recommended the purchase of stocks to their investment fund clients (pension funds, insurance companies, wealthy private individuals) based on research conducted by the investment banks’ own financial analysts. This created what is known as a ‘conflict of interests’ – or more prosaically, the possible exploitation of investors. Analysts’ remuneration is determined by the amount of fees from the sale of stocks that they are able to generate for their own investment bank. Aside from ‘churning’, profits can be further increased by producing favourable reports on the investment potential of the shares of the investment bank’s own corporate clients. A 1992 Morgan Stanley memorandum, for example, wished it to be ‘fully understood by the entire firm, including the research department, that we do not make negative or controversial comments about a client as a matter of sound business practice’ (Chancellor 2001b: 30). During the build-up to the information technology bubble in the early 1990s, the ratio of ‘buy’ to ‘sell’ recommendations made by analysts to investors rose from 6 to 8:1 near 100 to 1 just before the bubble burst in 2000.

The late 1990s ‘dot.com’ bubble was also inflated, and with it the investment bank profits, by the promotion of new ‘start-up’ companies in which the banks had invested before they were offered in a public flotation of shares. These offers were again accompanied by their analysts’ ‘buy’ recommendations. Chase Manhattan’s disposal of its equity in an internet software company, Infospace, following flotation, realized 45,000 per cent profit. As entirely new ventures, such internet companies had no histories on which to base sound judgments and, of course, many failed, bursting the bubble.

At this stage the investment banks had already realized capital gains in addition to fees and commissions. The small investors, who had no access to the shares before their flotation and were not part of the insider network that received an allocation of shares at the point of issue, experienced the biggest losses when the market turned (Chancellor 2001a; 2001b).

Investigations into serious ‘bubbles’, such as 1929 and 1998–9, routinely uncover malpractice in the financial system: insider trading, false accounting and so on. And, without it is concluded that this is the work of deviant individuals.
In other words, it is very strongly implied that the system is fundamentally sound and that any minor defects that corrupt malpractice must be corrected and the perpetrators must be severely punished. It is imperative that trust is restored in the 'headquarters' of the capitalist system. After Spitzer's investigation, remedial legislation was introduced and individual transgressors were successfully prosecuted. As if to show their serious intent, the icon of American respectable middle-class domesticity - the TV lifestyle presenter, Martha Stewart - was imprisoned for a relatively minor infringement of the rules for sales of stock. The Sarbanes-Oxley Act, 2002, introduced a requirement of greater transparency in the publication of information and measures to prevent the use of inside information. However, no attempt was made to deal with the concentration of power in the Wall Street bank oligopoly which many observers believe places them in a position to monopolize opportunities for profit-making, enrich themselves and, some would argue, exploit investors (Augar 2006).

However, the concentration of power at the upper levels of capital and financial markets is such that the major investment banks actually have no need to resort to illegal manipulation. As elsewhere in modern capitalism, these markets are dominated by an oligopoly whose constituent firms, by virtue of their large share of market activity and vastly superior information about investment opportunities, are in a structurally advantageous position. Even if all the rules and regulations that prohibit deliberate manipulation and insider trading are scrupulously observed, investment bank intermediaries have an edge over other participants.

Wall Street's edge is knowledge and integration. The large investment banks know more than any other institution or organization about the world's economy. They know more than their clients, more than their smaller competitors, more than the central banks, more than Congress, more than Parliament, more than the Chancellor of the Exchequer and more than the Secretary of the United States Treasury. (Augar 2006: 107)

In addition to their own research departments, the flow of information from their clients to the tiny group of dominant investment banks - Goldman Sachs, Morgan Stanley, Merrill Lynch, Citigroup, and JPMorgan Chase - enables them to anticipate the direction and level of demand for investment assets (Augar 2006: 11). In other words, the oligarchs cannot avoid very quickly becoming aware which assets are about to trigger wider demand and therefore rising; or, conversely, which are about to fall. (As investment risks are on both sides of market transactions - advising buyers and sellers, they are set to gain whichever way market moves.) Their structural location puts these dominant banks ahead of the other market participants. Arthur Levitt, chairman of the US regulatory authority Securities and Exchange Commission, likened the capital market to an auction in which the auctioneer bids whilst conducting the auction, or to a card game in which one player gets to see everyone else's hand (Augar 2006: 113). The pro-capitalist, The Economist, was similarly astonished:

Goldman Sachs now finds itself on so many sides of a deal simultaneously that the mind boggles. Goldman's merchant bank arm competes with clients (and counts them as customers), and its proprietary arm may trade against them. At the same time as it represents a firm, it could be shopping for its sole, attempting to buy it for itself, or competing for an acquisition on behalf of another client. Occasionally - but only occasionally - these roles become so apparent that the conflict becomes public. (The Economist, 29 April 2006: 78).

As one would expect in the inner sanctum of the 'headquarters of capitalism', the profits of the Wall Street financial oligopoly reflect their power. Investment banking has 'outformed the bulk of American industry by a country mile over thirty years'; for example, profits in the American utilities industry between 1975 and 2000 grew 26-fold, from $804 million to $21 billion - four times the rate of increase in corporate profits and US GDP (Augar 2006: 52). Drying their dominance, investment bankers' remuneration comprising salaries, bonuses and stock options - is, by a considerable margin, the largest in an increasingly unequal capitalist world. These 'predators' of Braudel's capitalist world are able to control flows of money through the
exchange networks and markets in such a way as to make enrichment an almost inevitable outcome (Braudel 1982: 30).

Since their emergence in the seventeenth century Italian city states, the controllers of the supply of money-capital at the apex of the financial markets have been the wealthiest and most powerful of all the capitalist classes. Little has changed since the Medici and other bankers struck the ‘memorable alliance’ with the early modern states from which modern capitalism was born. Shortly before Christmas 2006, Lloyd Blankfein, chief executive of Goldman Sachs, reported to the assembled partners on their company’s record performance over the previous year. Earnings had risen by 70 per cent to $9.5 billion, providing for an average annual salary (excluding bonuses) of $620,000 for the staff of 26,000, and over $50 million for Blankfein himself. Earlier in the year he had succeeded Hank Paulson, who had left the firm to become President George W. Bush’s US Treasury Secretary, a position occupied by another Goldman Sachs chief executive, Robert Rubin, in President Bill Clinton’s administration between 1995 and 1999. The firm has a long history of supplying the US government with personnel, but in November 2006 ‘the appointment...of Goldman Sachs’s William Dudley to head the Federal Reserve Bank of New York market’s group raised to an unprecedented level the number of top positions in public service that former executives from any one company have held during a White House administration’ (Financial Times, 4 December 2006: 5).

The enterprise as a commodity: mergers and acquisitions

With shares quoted on the stock market, the typical modern capitalist corporation is itself a marketable financial asset to be bought and sold. As we have already noted, the ‘mergers and acquisitions’ business is a central and growing part of the capitalist system. Once again, we see the same conflicting interpretations of the capital market. On the one hand, it is maintained that the threat of ‘takeover’ stimulates corporate management to greater efficiency and profitability in order to ease the share price, making the enterprise more expensive to acquire and thus reducing the probability of takeover. There are two counter-arguments, as Keynes implied in his analysis of the stock market (see pp. 45–7). First, it is held the short-term concern with maintaining profits and dividends can be at the expense of the longer-term development of technological innovation and efficiency. And, it is argued that most acquisitions are by predatory financial capitalists who are motivated precisely by this strategy of increasing the short-term stock-market valuation of corporations for a quick resale and profit. In this view, ‘leveraged buyouts’ are simply expressions of conflict for the control of the enterprise’s assets with no particular significance for economic efficiency.

In the previous chapter we discussed this question with regard to the intra-enterprise struggle; here we will focus on financial entrepreneurs – the ‘corporate raiders’. Fuelled by the availability of cheap bank credit, there were waves of acquisitions during the 1960s and 1980s in the major stock-based economies, in which large corporations were structured and remarkedeted. Mergers undertaken by corporations wishing to increase their market share by the elimination of competitors frequently created a conglomerate comprising sectors and divisions of quite different levels of profitability. These proved to be attractive prey for financial entrepreneurs, such as Slater-Walker in 1960s Britain and T. Boone Pickens in the USA during the 1980s, who searched for those corporations which were potentially valuable when disaggregated and sold in parts – that is, ‘asset-stripped’.

After a lull during the 1990s the struggle for control of the enterprise’s surplus has once again intensified with the advent of powerful associations of money-capitalists, known as ‘executive’ groups – for example, Carlyle Group, Blackstone, Permira and a prominent ‘corporate raider’ from the Kohlberg Kravis Roberts (KKR). These are consortia of healthy individuals whose creditworthiness enables them to take out large bank loans in order to gain control of enterprises by hostile takeovers. Once control is achieved the companies become wholly privately owned. The value of these
transactions has grown enormously. On 20 November 2006 the ownership structure of entire sectors of the major economies was reshaped in a single twenty-four hour period by a ‘fever’ of acquisition deals worth over $75 billion, ‘highlighting the extent to which private pools of money are coming to dominate vast swathes of the global economy’ (Financial Times, 21 November 2006: 17). By the end of 2006 the total of private equity buyouts had reached a record of $709 billion, more than doubling the 2005 level (Financial Times, 21 December 2006: 17). By early 2007 about 20 per cent of all private-sector workers in Britain were employed by private-equity-owned enterprises – for example, the Automobile Association, Birds Eye Food and Boots, which was bought for $16.62 billion, by a consortium led by KKR, which also holds the current record for the most expensive buyout – $44.37 billion for the US energy and utilities giant TXU (Financial Times, Special Report, ‘Private Equity’, 25 April 2007).

Typically, private equity groups aim to increase the profitability and market value of an acquired company over a period of three to five years in order to sell it at a profit. It is claimed that between 1995 and 2005 private equity generated annual returns which were roughly double those from dividends in UK equities and also compared favourably with the other high-performing assets such as property (Froud and Williams 2007). Having bought out the shareholders and broken any alliance with the enterprise management, the increased profits remain entirely in the hands of the financial entrepreneurs, further increasing the trend towards the redistribution of the surplus away from wages and salaries to money-capital. For example, in 2006 the rate of return on capital in Britain rose to 15 per cent – the highest since data were first collected in 1965. In contrast, the share of national income received by workers is the lowest since the early 1980s (Prospect, May 2007: 9).

Private equity differs from the 1980s ‘corporate raids’ in that the acquisitions extend beyond the publicly owned corporations whose shares can be acquired on the stock market. Family businesses, not only in the USA and the UK but also in continental Europe, including Germany, are also targeted. This has led to suggestions that the historic differences between the stock market and bank-based financial systems might be further eroded by this latest shift in the perpetual struggle to extract and capture value from the capitalist process (Froud and Williams 2007).

This move towards private concentrated ownership represents a break with the twentieth-century trend towards management-controlled and publicly owned corporations in economies such as the USA and the UK (see the discussion in chapter 6). Supporters argue that it represents a return to a ‘very pure form of capitalism’ (Financial Times, 24 August 2004), which is ‘in many ways a superior form of capitalism’ (The Economist, 27 November 2005). The concentration of ownership and its reintegration with control that private equity brings is considered to be more efficient because it no longer necessary to ‘heed the demands of a wide range of stakeholders, employees, management, lenders, unions and politicians’, which, it is contended, impedes the efficient allocation of capital (Financial Times, 3 February 2007: 15). In other words, power in the wholly privately owned is less diffuse and the prerogative of maximizing returns to capital can be ruthlessly followed. This is consistent with the classical economic liberal defence of private ownership as the means by which individual interest is harnessed to the public good. In support, an analysis of the thirty largest private equity deals carried out during 2003–4 claims that they resulted in an overall increase in employment (Financial Times, 2 April 2007: 3).

On the other hand, trade unions and other opponents of the concentration of power in the hands of private capitalists argue that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely a temporary measure that any overall creation of work is merely 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Financial risk management and speculation

We have already noted that a large part of the recent enormous expansion of the financial system has been due to the astonishing growth of speculative 'derivatives' markets and the volume of debt by which they are financed. Thirty years ago the global value of derivatives trades was less than $10 million, but by the early twenty-first century trading on these markets was estimated to be over $400 trillion and to be growing at 30 per cent per annum. To put this in perspective, the annual value of trading is now about thirty times greater than the gross domestic product of the US economy, which was $12.4 trillion in 2005 (Bank for International Settlements 2007).

Derivatives, in particular ‘futures’, developed out of techniques designed to reduce exposure to losses in commodity markets where the supply and, consequently, prices were subject to unpredictable fluctuations – for example where the supply of agricultural crops is determined by the vagaries of the weather. In response to this uncertainty, markets in agricultural commodities became organized around ‘forward’ and/or ‘option’ contracts to buy or sell a particular crop, ahead of the harvest, at an agreed price. For example, an orange-juice producer might contract with an orange grower to buy oranges at a certain price in order to be able to produce the juice at a calculable cost and to deliver it to the retailer at an agreed price. With changes in weather conditions, the anticipated, contractually agreed ‘future’ price could diverge from the actual price at harvest. Consequently, the original contract of the ‘future’ price becomes marketable as a speculative asset during the period up to the actual harvest. Eventually, these assets were organized into futures markets – such as the Chicago Mercantile Exchange and Board of Trade (1849) – in which the futures contracts to buy or sell a particular commodity at a certain price at a stated date were traded. In short, speculators, in effect, gambling on the rise or fall of commodity prices and their deviation at the stated date from the price specified in the futures contract. However, such speculation...
is only possible in markets with a particular organizational structure.

In the simplest terms, futures markets comprise three players – *hedgers, speculators* and the intermediary *market-makers* who organize the trades in the contracts between hedgers and speculators at the commercial exchange. The market enables the producers of orange juice, who have agreed to supply orange juice at a certain price, to hedge the risk of a rise in the price of oranges by buying an orange futures contract which specifies a conjectural ‘future’ price of oranges at the time of the harvest. Speculators buy futures contracts in the expectation of price changes. If the price of actual oranges rises above the contract price, the hedging producer’s potential loss in selling to the supermarket at the agreed price is offset by a precisely compensating gain when the futures contract is settled. Conversely, if the price of oranges falls, the hedger’s loss on the futures contract is offset precisely by the ability to produce juice more cheaply than anticipated because of the orange’s fall in price.

The largest of all derivative markets is now in foreign exchange, where importers and exporters can hedge the considerable risks which accompany rapidly increasing levels of international trade in a regime of floating exchange rates. Exchange-rate fluctuations and interest-rate changes present an enormous potential for speculative derivative trading. In the space of twenty years these markets have grown from a marginal position in the capitalist system to a volume of business that is equivalent to six times the value of the global gross product (*Financial Times*, 19 June 2007: 13). The expansion was triggered by the enormous increase in economic uncertainty unleashed by the collapse of the Bretton Woods semi-fixed exchange-rate regime in the early 1970s (see pp. 209–11). The subsequent floating and rapidly fluctuating exchange rates created both the need for hedging and the opportunity for speculation. Advances in computerized information and communication technology have further accelerated the development of these basic techniques of risk management.

It is widely held that these markets harness otherwise unproductive speculation to the effective management of ‘market risk’ – that is to say, the unpredictable price changes

*disturb the calculation of cash flows, and the risk aversion of speculators to bear huge losses themselves in order to prevent others from doing so.* Therefore, it is argued that speculators are indispensable to the functioning of capital markets. As a means of dealing with uncontrollable uncertainty, derivatives are valued, from this perspective, as the rationalization of economic transactions and the central characteristics of modern capitalism. On the other hand, it is contended that speculation increases price volatility, distorts the market for commodities. During times of high prices for consumers remained high if prices were not speculative. In other words, speculators would appear to have accelerated the price increase in the price of crude oil (4). More importantly, hedgers, speculators, and other financial market participants, are financed by the *danger of ‘credit risk’* – the *danger of default* – a threat to honour the futures contract. Default might trigger a chain reaction, especially in the financial markets, but also in the real economy. The process of debt deflation and social dislocation has attempted to rescue the financial system from its own management after its collapse for many years, but the collapse of the US Federal Reserve and the European Central Bank has been a new source of anxiety.

However, the possibility of deriva-
tive world of modern capital-
tial technology – ‘Credit risk’ is also ‘commodified’ with it. One way to do it is via a credit-default swap (CDS) entailing the transfer by a borrower to a special risk protection, the bank protecting the borrower, a periodic fee in return for deflating the risk of the borrower’s debt in the future. Further, such credit derivatives as ‘collateralized debt

on risk in this way lowers the banks’ own risk profile, permitting them to lend even more, further increasing the amount of credit in the system to finance more derivative speculation. These financial assets were virtually unknown a decade ago, but midway through 2006 their amount outstanding had grown to $26 trillion (Economist, 23 September 2006: 83–5).

As we have noted, the rapid growth of derivatives markets has been driven by ‘hedge-fund’ investment. Typically, like their private-equity cousins, these consist of small private associations of extremely wealthy individuals which are constituted in such a way as to operate largely outside the range of financial regulatory authorities, such as the US Securities and Exchange Commission and the UK Financial Services Authority. The creditworthiness of the wealthy members enables them to borrow up to more than twenty times the value of their own stake from commercial banks to finance speculation. Although difficult to estimate, the hedge funds’ pool of assets placed on the derivatives markets has grown at truly astonishing speed to an enormous size – from $257 billion in 1996 to $1.2 trillion in 2006 (Economist, 1 July 2006).

It is not perhaps surprising that hedge fund managers, dealing in such enormous sums of money, are able to award themselves commensurate salaries. In 2005, the average annual salary of the top twenty-five hedge fund managers rose by 45 per cent to $363 million; at the top of the list were James Simons of Renaissance Technologies ($1.5 billion), T. Boone Pickens of BP Capital Management ($1.4 bn) and George Soros of Soros Fund Management ($840 million) (Financial Times, 26 May 2006). In contrast, a typical chief executive officer of a top-500 US corporation in 2004 earned a mere $10 million (US Institutional Investor Magazine, 2005).

As in the primary capital market, discussed earlier, finance for derivative trading comes not only from newly created bank debt but also from existing pools of savings to be found in the large private pension and insurance company funds of the mature capitalist economies. The greater demands placed upon them by the increasing average human lifespan and the growing propensity for damages litigation have led these financial institutions to make a relative shift from equities and bonds to higher yielding, but more risky, derivatives. This linkage affects the everyday lives of the mass of the population. Capitalism’s very apex and is considered, as we shall see, an increased possibility that a serious contagious financial crisis could permeate the entire economy. The loss of savings and pensions (Blackburn 2006).

However, opinion is sharply divided on the question of the balance between the positive and negative aspects of speculation. Does financial speculation create destabilizing volatility and uncertainty, or is it, somewhat counter-intuitively, a vitally important tool for risk management in an uncertain world? Defenders of the markets point to the fact that hedge funds have collapsed and defaulted on their debts without causing serious dislocation. In short, a view believes that economic techniques can solve the fundamental problem of economic uncertainty. It is conceded that spectacular losses can lead to the collapse of individual participants – the bankruptcy of Orange County, California, in 1994 after a loss of $1.6 billion on derivatives; Nick Leeson’s loss of $1.4 billion on currency futures at Barings in 1995; and the collapse of Long Term Capital Management in 1998. Such events are to be feared, it is argued, but, as a consequence of increasingly sophisticated credit-risk management, the defaults did not contaminate the financial system and into the economy as a whole. On the contrary, the most serious worry at the time of writing, Amaranth, lost over $6 billion on natural gas speculation in 2006 and left the scene with a loss of perhaps $30 billion without causing anything more than the slightest ripple in the financial markets.

The less, the regulatory authorities in the USA and UK show increasing apprehension, shared by other staunchest supporters of capitalism, that the size of the unincurred in derivatives speculation does pose a serious threat. Were ‘hedge funds the flawed product of a freakish bubble’, the Financial Times asked in 2006 (Financial Times, 5 May 2006). A US Republican senator has called them ‘Wild West’ of the financial system (Economist, 1 July 2006), and in his 2002 annual report Warren Buffet, the
charismatic head of US investment company and hedge fund
Berkshire Hathaway, referred to them as ‘financial weapons
of mass destruction’. Financial authorities are concerned that
the hedge funds’ debts are becoming too large to manage and
that the level of concentration in the banking oligopoly makes
it especially vulnerable to a large default. Over the past twenty
years the five largest US banks, for example, have doubled
their share of the total banking system’s assets, to 45 per cent.
Moreover, the banks are not only the source of the finance
for hedge funds banks but also the holders of derivative con-
tracts in which one party must lose as the price of the under-
lying commodity changes. The largest five US banks hold 95
per cent of the total stock of derivatives and JPMorgan Chase
holds more than half the total; this ‘changed financial land-
scape may be eroding resistance to systemic risk’ (Financial
Times, 16 February 2005).

Credit-derivatives manage risk, but they do not and,
indeed, cannot eliminate the possibility of default; rather,
they merely spread and move the debt around. In essence,
the avoidance of a chain reaction of defaults and possible
systemic crisis leading to an economy-wide debt-deflation
depends, as always, on the availability of further credit-money
to bail out the failing debtors. Ultimately, this can only be
provided successfully, directly or indirectly, by the state’s
central bank, as has occurred in recent times, for example,
during the UK’s secondary banking crisis (1973), the USA’s
Savings and Loan collapse in the 1980s, Long Term Credit
Management’s rescue in 1998, and, most recently, in the US
‘subprime’ mortgage crisis and its spread to the mortgage
bank Northern Rock, causing the first ‘bank run’ in Britain
for over 150 years.9

During August 2007 asset prices fell dramatically on
the global capital and financial markets as a result of defaults
on credit derivatives and securitized loans on the US ‘sub-
prime’ housing mortgage market – that is to say, loans
to high-risk borrowers. Lenders hedged their credit risk in
the derivatives market and also securitized and sold on their
mortgage contracts. This encouraged even greater risk taking
by the extension of loans to progressively lower-income
groups. Again, we see the contradiction between individual
rationality and system instability, as observed by Keynes in
analysis of the stock market. The lenders were rational
selling their individual risk of debtor default, but this
caused the aggregate threat to the financial system. As the
securitized mortgages had been widely trading on impen-
sively complex global markets, it was almost impossible to
identify which banks and financial enterprises had been left
holding the defaulted debt. This further reduced confidence
in the markets, and investors in such instruments tried to
protect themselves of the risk by selling the assets. Conse-
quently, the credit derivatives and securitized mortgages
became ‘illiquid’ (unsaleable) and the contagion spread to
other asset markets, including the major stock markets, and
actually to the very core of the financial system – that is,
the money markets in which banks lend to each other.

As became reluctant to lend for fear that the borrower
might be holding vulnerable credit derivatives and securi-
tized mortgages. Consequently the rate of interest on these
bank loans increased significantly and the supply of
credit-money the lifeblood of the capitalist system began
to dry up in a credit ‘squeeze’ or ‘crunch’. To avoid a defla-
tory impact on the economy, the major central banks (the
Federal Reserve, the European Central Bank and the
Bank of England) extended loans to their banking systems.

Major banks reported having to write off bad loans
and announced large losses. At the time of writing the crisis
had produced only two major casualties – the British mort-
gage bank Northern Rock and the Wall Street investment
bank Bear Stearns. But almost all the major investment
banks had suffered large losses.10 By early 2008 a significa-
tional downturn was being forecast for those major capitalist
economies most closely linked to the credit crisis, and the
threat of a full-scale debt deflation was by no means
ousted.11

The ‘financialization’ of modern capitalism in the sense of
increasing dominance of financial practices and the fusion
of business enterprise with ‘financial engineering’ was evident
in the wake of corporate scandals that occurred around the
twenty-first century at the time of the collapse of
the dot.com’ boom. As usual, the subsequent investigations
provided the public a rare glimpse into the upper reaches of
capitalist system.
The Enron affair

The fall in disgrace of the US Enron Corporation in 2001 gives us some idea of the complexity of the relations between the investment banks and corporations and of the way in which derivatives markets have begun to blur the separation of the spheres of production and purely financial transactions. With the successful prosecution of the chief executives for fraud, Enron's demise was widely portrayed as the result of the corruption and dishonesty of individual 'bad apples'. However, as we have noted with regard to the Wall Street investment banks, it is important not to lose sight of how the structure and practices of the financial system in which these individuals operated enabled their particular kind of malpractice to occur at the very highest levels of the US economy.

Enron was named 'America’s most Innovative Company' by Fortune Magazine for six consecutive years in the 1990s, and, until the loss of jobs and pensions, its 21,000 employees were in one of the magazine’s list of '100 best companies to work for in America'. Enron recorded revenues of over $100 billion in 2000, but eventually it was revealed that the company, with the connivance of its auditor Arthur Andersen, had been able to keep its staggering high losses and enormous debts off its published balance sheet. On this disclosure, the price of Enron’s stock dropped from $90 to 30 cents and it filed for bankruptcy on 2 December 2001 with over $40 billion of debts. Inquiries not only revealed insider trading, bribery and corruption; they also showed how some investment banks operate and the resulting pervasive influence of financial practices.

Enron was formed in 1985 as a Texas-based corporation involved in buying and distributing gas and electricity and in the construction and operation of energy infrastructure – pipelines, power plants and so on. Like other suppliers, Enron hedged its trades in the new energy derivatives markets, but it did so to such an extent that by 1999 its original pipeline business had been drastically reduced and the company had set up its own web-based energy derivatives trading system, Enron Online. By the time of the collapse, Enron was trading 800 commodities and derivatives – metals, forestry, risk management, sugar, coffee and, most significantly, credit-risk management and the buying and selling of options in the ‘mergers and acquisitions’ business. In 1999, Enron had left the sphere of production and distribution and had transformed itself into a financial firm, pursuing ‘Monetize. That was the buzzword,’ a senior Enron executive later explained to the investors (Financial Times, 1 March 2002: 28).

As Enron abandoned its energy distribution pipeline assets and lost their cash revenues, it required vast loans from the Wall Street investment banks to finance its derivatives and mergers and acquisitions business. In 2000 alone, Enron paid more than $250 million in fees – in addition to the interest on loans – to banks, including Credit Suisse First Boston, Merrill Lynch, Chase, Citigroup, and Morgan. According to one of them, Enron was the ‘golden goose’ (Financial Times, 1 March 2002: 28).

The key to Enron’s continued expansion, and with it, of course, the profits of the Wall Street investment banks, was the continuous rise not only of its own stock-market valuation but also, after the deals had been done, of the shares of the corporations it had acquired for resale. Not surprisingly, the investment bank creditors consistently recommended stocks as ‘strong buys’. Indeed, brokers at Credit Suisse First Boston and Lehman Brothers continued with their positive recommendation to the markets until only a few days before Enron filed for bankruptcy (Financial Times, 1 March 2002: 28). As Enron’s stock price rose to its peak of $90 in mid-2001, its executives, who knew of the hidden losses, began to sell their stock and, at the same time, reassured the public that any falls were temporary and that prices would rise to the $130 to $140 range. The investing public, Enron’s employees suffered the consequences of the deception.

Further malpractice was revealed after the collapse of other US companies – such as Worldcom – in the wake of the ringing of the ‘dot.com’ financial bubble in 2000. As we have seen, scandals set in train a process of re-legitimization, adding the Sarbanes-Oxley legislation which was intended to increase the disclosure of company accounts and executive
Conclusion

Typically, the initial phase that inaugurates the capitalist production of commodities is the raising of finance in the primary capital market. On the basis of an assessment of the prospects of enterprise profitability in accordance with accounting conventions, banks have the power to create the supply of money-capital for its finance, either directly in the form of bank loans or indirectly for the purchase of equities. In capitalism, whether or not production takes place rests largely on the decisions made by Schumpeter's 'merchants of debt'. Of course, their power is not absolute and ultimately depends on the continuation of a steady flow of revenues from profitable enterprises to cancel the debts. None the less, it is the capital market, not merely retained profits, which inaugurates and fuels the dynamic expansion of the system.

All opportunities for the realization of profits – that is to say, prospective profits – from all forms of capitalist activity can be transformed into speculative financial assets. Pure speculation adds nothing directly to the production of commodities, but, by providing the capital and financial markets with a supply of money, it confers the liquidity and fungibility of all assets. In turn, liquidity and fungibility give capitalism a flexibility which reinforces its inherent dynamism. Capital can be transformed into money and switched to whatever and wherever the prospects of profit seem greater. Sustained, long-term economic expansion has never taken place without the existence of extensive capital and financial markets (Rousseau and Sylla 2006).

However, the relation of money-capital with production is not simply a matter of the smooth functional transfer of finance to the most profitable destinations, as it is in the economic 'circular flow' model. There is also a negative side to the links between these two fundamental elements of the capitalist economy. First, the power of money-capital and the quest for liquidity can result in the extraction of capital from the production of goods and services and employment and the pursuit of pure, particularly speculative, financial transactions. The profitability of pure financial exchange might divert money-capital from the production and sale of goods and thereby deplete the revenues which are necessary to service the debt that finances the production, as we have seen in the 'private equity' debate. Second, the dynamism and flexibility provided by capital markets and readily produced credit money is necessarily accompanied by the possibility of collapse and stagnation. In other words, the corollary of debt-financed expansion is default and the unravelling of the credit networks that sustain it. Speculative derivative markets have been harnessed to the attempt to avoid this outcome, but the credit-default-swaps and other instruments cannot resolve the contradiction. This supposed solution involves an infinite regress in which further debt is created to finance the credit derivatives. As we have noted, the effects of defaults in the US subprime mortgage market that began in summer 2007 were still being felt in summer 2008. Billions of dollars of financial assets were being written off by US and European banks as the securitized mortgages and credit-default-swaps became 'illiquid' – that is to say, unsaleable depreciating assets. This reduced the banks' capital base and impaired their capacity to lend to each other and to their borrowers. Moreover, the anonymous, impersonal nature of the securitization market made it difficult to ascertain which banks were most affected, which further reduced trust and confidence.

Capital and financial markets comprise the powerful nerve centre of the capitalist system in which the creation of money-capital and its deployment is controlled by the investment banks and financial enterprises. However, these markets cannot be seen simply as channels for the efficient transmission of savings to the most profitable destinations and their operators merely as neutral 'intermediaries'. From sixteenth-century Italy to the City of London and Wall Street today, bankers and financiers have been the wealthiest and most powerful members of the capitalist classes. As a result of record hedge fund investment in 2006, 'the combined earnings of the world's top 25 hedge fund managers of almost £5bn exceeded the national income of Jordan'. Three
individuals took home more than $1 billion and average earnings of the top twenty-five more than doubled between 2004 and 2006 to $570 million (Financial Times, 24 April 2007: 1). There is no evidence to suggest that this level of remuneration is determined exclusively by their functional contribution to ’transactions efficiency’ in the financial markets. That is to say, the current trend towards ’financialization’ once again raises the question for which there is no clear answer. How are developments in the structure of capitalism to be explained? In this instance, do financial asset markets simply represent the solution to economic problems for which their operators receive a commensurate reward (see Rajan and Zingales 2004)? Or do money and finance capitalists have the power to create instruments and practices of self-enrichment? Regardless of any other consideration, Adam Smith’s argument that private individual profit-seeking resulted in the public benefit of economic growth depends on the existence of a high level of market competition. And, as we have seen, this condition scarcely applies in modern capitalism.

Discussions of the emergence of ’financialization’ as a new stage in the development of capitalism tend to overlook the fact that the guiding principle of capitalist activity has always been ’liquidity’ – that is, the sequential transformation of all assets into money, back again into assets and so on (see the discussion in Arrighi 1994: 2–4). Previous eras have also seen rises in the relative dominance of finance, but they have never before been on such a scale. On all these occasions and especially today, the expansion of finance in relation to production has been accompanied, as we have noted in passing, by a significant rise in inequality, which has reversed the egalitarian trend of the second half of the twentieth century (Phillips 1993, 2002; Duménil and Lévy 2004a). This question will be taken up in our concluding chapter.

The state

The two logics of power

One of capitalism’s distinctive characteristics lies in the particular historical coexistence and mutual dependence of two kinds of power: private economic power from the control of property and opportunities for profit-making, and the coercive territorial power of states. The question of the proper relationships and boundaries between the two has been continuously disputed since the moment in early modern Europe when this private economic power, having been nurtured and protected by the developing states, became sufficiently strong to demand greater freedom in its pursuit of profit. The Wealth of Nations, it will be recalled, was Smith’s rebuttal of state-inspired mercantilist economic doctrines. He argued that the material advance of civilization required the liberty to pursue commerce without interference and competition from the state.

Relations between market-capitalism and the state express the interaction of these two interdependent, but different, logics’ of power and space (Arrighi 1994: 32–5; Tilly 1990). On the one hand, power can be based on the direct control of the territory in which human and material resources are to be found. After a calculation of the costs of acquisition in relation to the putative benefits of possession, power can be the means through conquest of the space which contains the