ROSA LUXEMBURG AND FINANCE

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Rosa Luxemburg is best known for her attempt in her book The Accumulation of Capital to show that capitalist accumulation requires external markets in order to overcome a tendency to stagnation. These external markets formed the basis of her theory of imperialism, which was taken over by Lenin and subsequent Marxists. However, in chapter xxx of that book, on 'International Loans', Rosa Luxemburg examined the role of finance in capital accumulation. This analysis was perhaps peripheral to her argument. But it has sufficient critical elements to warrant a place for Luxemburg among the pioneers of critical finance, while the fate of that analysis among Marxists reveals how the most important school of radical political economy in the twentieth century came to an attenuated view of finance as a factor in capitalist crisis. In this paper, it is argued that Luxemburg put forward an analysis of international finance that not only allows for a disturbing character of finance, but also looks forward to important aspects of Minsky's analysis in the second half of the twentieth century.

1. Rosa Luxemburg's Criticism of International Banking

For Luxemburg, the context of the system of international loans was crucial. Advanced capitalist countries faced crises of 'realisation' i.e., inadequate demand to allow profits to accrue. At the same time, developing countries lacked the markets for commodity production to take place on a capitalist scale. She argued that international loans are crucial in providing finance so that dependent and colonial countries can buy the equipment to develop their economic and industrial infrastructure, reaching political independence but tied into financial dependence on the older capitalist states:

'In the Imperialist Era, the foreign loan played an outstanding part as a means for young capitalist countries to acquire independence. The contradictions inherent in the modern system of foreign loans are the concrete expression of those which characterise the imperialist phase. Though foreign loans are indispensable for the emancipation of the rising capitalist states, they are yet the surest ties by which the old capitalist states maintain their influence, exercise financial control and exert pressure on the customs, foreign and commercial policy of the young capitalist states… such loans widen the scope for the accumulation of capital; but at the same time they restrict it by creating new competition for the investing countries.'[1]

The raising of the loans and the sale of the bonds therefore occur in exaggerated anticipation of profits. When those hopes are dashed, a crisis of over-indebtedness breaks out. The governments of the dependent and colonial territories are obliged to socialise the debts, and make them a charge on their tax revenues. However, by this time the loans have served their primary purpose, which is to finance the export of capital equipment from the advanced capitalist countries, thereby adding to their profits and capital accumulation. With the crisis, capital accumulation comes to a halt, before new issues of bonds and loans finance capital exports to another country and capital accumulation is resumed.

The financial crisis is overcome mainly at the cost of destroying the agricultural economy of the developing countries:

'While the realisation of the surplus value requires only the general spreading of commodity production, its capitalisation demands the progressive supercession of simple commodity production by capitalist economy, with the corollary that the limits to both the realisation and the capitalisation of surplus value keep contracting ever more.'[2]

Ultimately the peasants have to pay the additional taxes and are destined to see their markets taken over by mass capitalist production. Luxemburg gave an extensive account of international loans in Egypt as an example. Here, 'the transactions between European loan capital and industrial capital are based upon relations which are extremely rational and "sound" for the accumulation of capital, because this loan capital pays for the orders from Egypt and the interest on one loan is paid out of a new loan. Stripped of all obscuring connecting links, these relations consist in the simple fact that European capital has largely swallowed up the Egyptian peasant economy. Enormous tracts of land , labour and labour products, accruing to the state as taxes, have ultimately been converted into European capital and have been accumulated… As against the fantastic increase of capital on the one hand, the other economic result is the ruin of peasant economy together with the growth of commodity exchange…'[3]

Similarly, in Turkey, 'railroad building and commodity exchange … are fostered by the state on the basis of the a rapid disintegration, ruin and exploitation of

Asiatic peasant economy in the course of which the Turkish state becomes more and more dependent on European capital, politically as well as financially.'[4]

2. The Marxian Reflective View of Finance

Luxemburg's analysis of finance did not win the favour of contemporary Marxist economists. In his pamphlet, Imperialism the Highest Stage of Capitalism, written in 1916, Lenin did not even mention Rosa Luxemburg, but based his economic explanation of imperialism on his critical reading of Hobson's Imperialism, and his view of the role of finance on Hilferding's Finance Capital. Hilferding's book had been published in 1910, three years before Luxemburg's, and put forward a more benign view of finance. Hilferding generalised from the experience of banking in Germany, where 'universal' banks organised the capital markets and thereby came to own often controlling stakes in large companies. He argued that banks were a crucial factor in the emergence of monopoly capitalism and the cartelisation of the capitalist economy. In Hilferding's view, the banks not only financed the industrial expansion of capitalism into dependent and colonial territories, but also restrained competition between capitalists and financed their cartels. If crises arose, they were due to disproportions in production and class struggles. By stabilising the markets and finances of the capitalists in their cartels, banks were able to shift the costs of those crises onto non-cartelised capitalists. Because it concentrates control over industry, finance capital facilitates the eventual socialisation of the means of production.[5]

In his insistence that capitalist crisis can only be due to disproportions in production, or struggles between the classes involved in it, Hilferding was undoubtedly the more orthodox Marxist. Marx's views on money and finance do not constitute a consistent analysis, largely because in his time finance was only just emerging into economic pre-eminence. Recent research by Anitra Nelson and Riccardo Bellofiore suggests those views themselves appear to have mangled in the course of Engels' editing of Marx's notes into the widely accepted versions of the second and third volumes of *Capital*.[6] However, in at least two respects Marx was in advance of the conventional, Ricardian thinking of his time. First of all, Marx distinguished explicitly between the rate of interest and the rate of profit: In the classical political economy of David Ricardo, the rate of interest and the rate of profit were virtually interchangeable.

Secondly, and related to his distinction between the rate of interest and the rate of profit, Marx distinguished between real, or productive, capital, and the 'fictitious' capital of financial assets.[7] Real capital is the stock of plant, equipment and materials out of which goods will be produced. Fictitious capital is the structure of financial claims on that capital. This is crucial for the process of equalising the rate of profit across industries. It is through the market for fictitious capital that money capital may be advanced to particular industries, and through that market, money may be taken out of particular industries and firms and transferred to others.

The scope and significance of finance in Marx's analysis is clearly laid out in chapter thirty-six of volume III of *Capital*. With the title 'Pre-capitalist Relations' it may seem an odd chapter in which to find Marx's conclusions on the role of finance in capitalism. But it does conclude Part V of the volume, a part that is entitled 'Division of Profit into Interest and Profit of Enterprise. Interest-Bearing Capital.' Moreover, the chapter has the added merit of authenticity: In his Preface, Engels wrote that 'The greatest difficulty was presented by Part V which dealt with the most complicated subject in the entire volume.' After fruitless attempts to complete various chapters in it, Engels confined himself to 'as orderly an arrangement of available matter as possible.' Of these chapters, the manuscript of 'the "Pre-capitalist" chapter (Chapter XXXVI) was quite complete.'[8]

The chapter discusses the historic emergence of credit from medieval systems of usury. Marx wrote that:

'The credit system develops as a reaction against usury. But this should not be misunderstood, nor by any means interpreted in the manner of the ancient writers, the church fathers, Luther or the early socialists. It signifies no more and no less than the subordination of interest-bearing capital to the conditions and requirements of the capitalist mode of production.'[9] Marx viewed the battle against usury as a 'demand for the subordination of interest-bearing capital to industrial capital.'[10] In this way, capital ceases to be the fragmentary wealth that is at the unhindered disposal of individual capitalists, but is socialised to be reallocated where the highest return may be obtained.

What is crucial here is the use of the word 'subordination'. It clearly indicates the view that finance and credit are led by developments in productive industry.[11] As Engels succinctly put it in a letter to Eduard Bernstein in 1883, 'The stock exchange simply adjusts the *distribution* of the surplus value *already stolen* from the workers…'

(Marx and Engels 1992, p. 433). In Volume III of *Capital* such adjustment is supposed to facilitate convergence, among firms and different activities, on an *average* rate of profit, whose decline then sets off *generalised* industrial crisis in capitalism.[12]

Although this could not have been foreseen at the time when Marx was writing, the development of the capitalist system went not towards the 'subordination' of finance to industrial capital, but in fact towards the subordination of industrial capital to finance. Hence the sluggish development of industry in capitalist countries that have come to be dominated by rentier capitalism, most notably the United Kingdom and the United States from the 1880s through to the 1930s, and from the 1980s onwards.

This development is central to the theory of capitalist crisis. In Marx economic depressions are supposed to arise from a decline in the *industrial* rate of profit. Marx, however, recognised that excessive expansion of credit may also give rise to crisis, when confidence in that credit falls, and demand for cash settlements rises. In volume III of capital, he suggested two kinds of such crisis. One was an internal banking crisis, 'when credit collapses completely and when not only commodities and securities are undiscountable and nothing counts any more but money payment… …Ignorant and mistaken bank legislation, such as that of 1844-1845 can intensify this money crisis. But no kind of bank legislation can eliminate a crisis.'[13]

The other kind of crisis that was familiar to Marx was the drain of gold for international payments attendant upon a balance of payments deficit. This results in the successive ruin of first importers and then exporters: 'over-imports and over-exports have taken place in all countries (we are not speaking here about crop failures etc., but about a general crisis); that is over-production promoted by credit and the general inflation of prices that goes with it.'[14] However, more modern crises of finance capitalism appear to be set off by disturbances in the financial system, which then spread to industry by devastating the balance sheets of industrial corporations. Notable examples of this are the 1929 Crash, and the Japanese economic crisis after 1991. For Marxists these raise very fundamental questions concerning the scope of Marx's analysis, that is the degree to which it indicates salient features of the capitalism of his time, and the degree to which that analysis remains true of capitalism everywhere at all times. This is not a dilemma peculiar to Marxists. It is one that affects adherents of all 'defunct economists'. Perhaps most of all it affects those ‘practical men who believe themselves to be quite exempt from any intellectual influences’ and who therefore do not yet understand that their ‘obvious’ ideas were invented by some defunct economist to enlighten circumstances that have since passed away.

Marx made one further assumption, that today would be considered controversial. This concerns the manner in which capitalist finance operates. One paragraph below his statement that capitalist finance is subordinated to industry, Marx wrote the following:

'What distinguishes interest-bearing capital - in so far as it is an essential element of the capitalist mode of production - from usurer's capital is by no means the nature and character of this capital itself. It is merely the altered conditions under which it operates, and consequently also the totally transformed character of the borrower, who confronts the money-lender. Even when a man without fortune receives credit in his capacity of industrialist or merchant, it occurs with the expectation that he will function as a capitalist and appropriate unpaid labour with the borrowed capital. He receives credit in his capacity of potential capitalist. The circumstance that a man without fortune but possessing energy, solidity, ability and business acumen may become a capitalist in this manner - and the commercial value of each individual is pretty accurately estimated under the capitalist mode of production - is greatly admired by apologists of the capitalist system. Although this circumstance continually brings an unwelcome number of new soldiers of fortune into the field and into competition with the already existing individual capitalists, it also reinforces the supremacy of capital itself, expands its base and enables it to recruit ever new forces for itself out of the substratum of society. In a similar way, the circumstance that the Catholic Church in the Middle Ages formed its hierarchy out of the best brains in the land, regardless of their estate, birth or fortune, was one of the principal means of consolidating ecclesiastical rule and suppressing the laity. The more a ruling class is able to assimilate the foremost minds of a ruled class, the more stable and dangerous becomes its rule.'[15]

This Schumpeterian vision comes close to the perfectly efficient intermediation view of finance. It is still the view that prevails in contemporary economics. The more fundamental critic of capitalism, in this regard, turns out to have been Michał Kalecki, who concluded that the key factor in capital accumulation was the 'free' capital owned by the entrepreneur. He wrote that:

'The limitation of the size of the firm by the availability of entrepreneurial capital goes to the very heart of the capitalist system. Many economists assume, at least in their abstract theories, a state of business democracy where anybody endowed with entrepreneurial ability can obtain capital for a business venture. This picture of the activities of the 'pure' entrepreneur is, to put it mildly, unrealistic. The most important prerequisite for becoming an entrepreneur is the *ownership* of capital.'[16]

Hints at a more complex view of finance by the founders of the Marxist school emerge in their correspondence, in particular the later letters which show a lively sensitivity to the way in which finance acquired economic importance as the nineteenth century progressed. In a letter in 1881 to the Russian economist and translator of *Capital* Nikolai Danielson, Marx noted how an influx of gold reserves can insulate the financial system from the industrial crisis: '…if the great industrial and commercial crisis Engand has passed through went over without the culminating financial crash at London, this *exceptional* phenomenon was only due to French money.'[17] In a later letter to the German social democrat leader August Bebel, in 1885, Engels noted how inflated financial markets would drive down interest rates. In the absence of higher returns from industry, money markets would stay liquid, but their liquidity would not induce industrial investment, a premonition of later English theories of liquidity preference:

'The chronic depression in all the decisive branches of industry also still continues unbroken here, in France and in America. Especially in iron and cotton. It is an unheard-of situation, though entirely the inevitable result of the capitalist system: such colossal over-production that it cannot even bring things to a crisis! The over-production of disposable capital seeking investment is so great that the rate of discount here actually fluctuates between 1 and 1½ per cent per annum, and for money invested in short-term credits, which can be called in or paid off from day to day (money on call) one can hardly get ½ per cent per annum. But by choosing to invest his money in this way than in new industrial undertakings the money capitalist is admitting how rotten the whole business looks to him. And this fear of new investments and old enterprises, which had already manifested itself in the crisis of 1867, is the main reason why things are not brought to an acute crises.'[18]

Finally, in 1890, looking back on his early years as an industrialist, Engels bemoaned the distorted view of industry that prevails in the financial markets and their self-regarding nature. He admitted that financial crises may occur that have little or no foundation in industrial reverses. Finance may develop in its own way, but is an arena for the struggle between various industrial interests. But ultimately the financial system must reflect production 'taken as a whole'. Engels' letter to the Swiss journalist Conrad Schmidt, date 27 October 1890, stands out as a succinct statement of the Marxian 'reflective' view of finance:

'The money market man only sees the movement of industry and of the world market in the inverted reflection of the money and the stock market and so effect becomes cause to him. I noted that in the 'forties already in Manchester: the London Stock Exchange reports were utterly useless for the course of industry and its periodical maxima and minima because these gentry tried to explain everything from crises on the money markets which were generally only symptoms. At that time, the object was to explain away the origin of industrial crises as temporary over-production, so that the thing had in addition its tendentious side, provocative of distortion. This point has not gone (for us, at any rate, for good and all), added to which it is indeed a fact that the money market can also have its own crises, in which direct disturbances of industry only play a subordinate part or no part at all – here there is still much, especially in the history of the last twenty years, to be examined and established…'

'… As soon as trading in money becomes separate from trade in commodities it has (under certain conditions imposed by production and commodity trade and within these limits) a development of its own, special laws and special phases determined by its own nature. If, in this further development, trade in money extends in addition to trade in securities and these securities are not only government securities but also industrial and transport stocks and shares, so that money trade conquers the direct control over a portion of the production by which, taken as a whole, it is itself controlled, then the reaction of money trading on production becomes still stronger and more complicated. The money traders have become the owners of railways, mines, iron works, etc. These means of production take on a double aspect: their working has to be directed sometimes in the immediate interests of production, but sometimes also according to the requirements of the shareholders, in so far as they are money traders. The most striking example of this is the American railways, whose working is entirely dependent on the stock exchange operations of a Jay Gould or a Vanderbilt, etc., these have nothing whatever to do with the particular railway concerned and its interests as a means of communication. And even here in

England we have seen struggles lasting for tens of years between different railway companies over the boundaries of their respective territories – struggles in which an enormous amount of money was thrown away, not in the interests of production and communications, but simply because of a rivalry which usually only had the object of facilitating the stock exchange dealings of the shareholding money traders.'[19]

In his critique of Luxemburg, Lenin's associate Nikolai Bukharin rebuked her for exaggerating the need for external markets and her neglect of finance as a centralising element in monopoly capitalism.[20] In line with Hilferding's analysis of finance as coordinating monopoly capitalism, Marxist critics have largely followed the founders of their school of thought to adhere to a 'reflective' view that, if financial crisis occurs, it is because correctly 'reflects' critical developments in production: a fall in the rate of profit, increased class struggle, disproportions, and so on. Even after the 1929 Crash, the Hungarian-Soviet economist Eugene Varga, provided a Marxist orthodoxy according to which 'the cause of the cyclical course of capitalist production is the accumulation of capital' resulting in excess industrial capacity.[21] The collapse of the long-term capital market was caused by such excess capacity.[22] More recently, Suzanne de Brunhoff went as far as any Marxist critic has gone in writing that:

'…the financial cycle is only a reflection of the economic cycle: monetary and financial movements reflect non-monetary and non-financial internal and international disturbances. But the reflect them *in their own way* because of the existence of specific financial structures.'[23] However, 'the capitalist form of production is unable to give an entirely functional character to the conditions under which it functions; the credit system preserves a relatively autonomous development. The resurgence of the monetary system in times of crisis is a sign of that autonomy, since the demand for money is completely outside the movement of real production. But the financial crisis also reduces the "fictitious" mushrooming of credits and restores the monetary basis of credit.'[24] But this is because stock prices and credit can fluctuate with a degree of independence of real capital, and inversely with the rate of interest.[25]

3. Luxemburg, Finance and Minsky

There is another aspect of Luxemburg's approach to finance that looks forward to the analysis of Hyman P. Minsky in the second half of the twentieth century. Minsky is well known as the author of the ‘financial instability hypothesis’ in which the progress of capitalist prosperity or growth autonomously generates circumstances of financial ‘fragility’ and crisis. Minsky, like many U.S. authors, had in the forefront of his mind the economic debilitation that was caused in his country by the 1929 Crash. He favoured government intervention to stabilise aggregate demand, as well as central bank loosening of monetary policy, to keep financial crisis at bay[26]. His political economy of finance was essentially a Keynesian one in which the state takes an active role in stabilising the financial system of its country.

Rosa Luxemburg’s political economy of finance is somewhat different, but arguably is no less current than Minsky’s. In her analysis, the financial system is international, but based in the advanced capitalist countries (as it is today). Governments are weak and, in the poorer countries, are dependent upon the international financial system for financing their loans. By contrast, Minsky’s analysis had in mind the U.S. government, and governments of advanced capitalist countries that are less dependent upon the international financial system, or at least have greater scope for manipulating it than is available to governments of poorer countries.

A much more distinctive feature of Luxemburg’s political economy of finance, by comparison with Minsky’s, lies in the way in which financial risk is socialised and the consequences of that socialisation. Minsky envisaged that a socialisation of financial risk would allow domestic business to flourish, with its markets underpinned jointly by financial stability and a welfare state. Luxemburg recognised that, in poorer countries, the socialisation of financial risk, through state guarantees of commercial foreign debts, has costs that are unequally distributed between locally-based and foreign-based enterprises. The locally-based ones, largely in traditional activities, have virtually no possibilities to escape from the tax demands of their government. Foreign-based enterprises, usually in the more modern sector of the economy, have huge possibilities of escape. Hence, the costs of foreign indebtedness in less developed countries are borne by the traditional sector that benefits least from foreign investment. Over the longer term, the traditional sector becomes economically marginalised, and the traditional state that underwrites the country’s foreign debts becomes politically marginalised. In this way the developing world approaches the neo-liberal ideal of a small state, whose apparent partiality for business masks an oppressive concentration of tax and debt burdens on households and businesses in the traditional sector. The economic dynamics of such states are then determined by financial inflows of foreign aid, and the pulse of foreign direct investment, punctuated by natural disasters and civil disorders.

The socialisation of risk in the more advanced capitalist countries envisaged by Minsky has somewhat different consequences. The sharing of the risks of financial enterprise facilitates credit inflation in capital markets in particular. The result has been apparent in recent years, in the U.S. and in Europe, in growing industrial concentration, and the rising influence of financial institutions over industrial corporations. But far from facilitating continuing accumulation, as Hilferding and to some degree Minsky expected, the combination of the socialisation of financial risk and industrial concentration has led, in the U.S. and the U.K. at least, to industrial stagnation, or slow growth at best. The 'monopoly capital' school of Marxist analysis had no doubt that this industrial stagnation was due to the decline of industrial competition. But a case may also be made for a more Veblenian analysis in which, as a result of financial market stabilisation, companies find that profits from refinancing their operations in the financial markets may be more easily and cleanly obtained than from productive activities. This was a possibility that Minsky foresaw, but to which he advanced no remedy.

4. Conclusion

Karl Polanyi, in his pioneering study of the social and institutional roots of economic and financial collapse in the 1930s, wrote that 'Marxist works, like Hilferding's or Lenin's studies, stressed the imperialistic forces emanating from national banking, and their organic connection with the heavy industries. Such an argument, besides being restricted mainly to Germany, necessarily failed to deal with international banking interests.'[27] In this regard Rosa Luxemburg was exceptional. Her analysis of the international loans system in the period preceding the First World War may have been incidental to her main argument about capitalist accumulation. But the view she portrayed of a financial system that visits repeated catastrophes on the traditional economy, in the course of incorporating it in the modern international capitalist economy, anticipates much of the experience of developing countries since the 1970s. The elements of critical finance in her work survive better than the model of accumulation in which they were framed.

References

1. Luxemburg *The Accumulation of Capital* Routledge 1951, p. 421.

2. loc. cit.

3. ibid. p. 438; see also Aaronovitch ‘Agriculture in the Colonies’ *Communist Review* July, 1946, pp. 21-26..

4. ibid. p. 445.

5. Hilferding *Finance Capital A Study of the Latest Phase of Capitalist Development*, edited and introduced by Tom Bottomore, translated by Morris Watnick and Sam Gordon, London: Routledge and Kegan Paul, 198,1 chapters 20 and 25.

6. Nelson *Marx’s Concept of Money: The God of Commodities* London: Routledge. 1998; see also Bellofiore *Essays on Volume III of Capital: Method, Value and Money* London: Macmillan 1998.

7. Marx *Capital, A Critique of Political Economy Volume III The Process of Capitalist Production as a Whole* edited by F. Engels, Moscow: Progress Publishers. 1959, chapter XXV.

8. ibid. pp. 4 and 6.

9. ibid. p. 600.

10. ibid. p. 603.

11. As in nearly everything that Marx wrote after the first volume of *Capital*, it is possible to question the interpretation of his analysis, because of the enormous scope that his notes left for editing. But this chapter suffered least from Engels' editing, and it has not been mis-translated: In the original German, the sentence about the subordination of finance to industrial production reads as follows: 'Es bedeutet nichts mehr und nichts weniger al die Unterordnung des zinstragenden Kapitals unter den Bedingungen und Bedűrfnisse der kapitalistischen Produktionweise.' (Marx *Das Kapital, Kritik der Politischen Ökonomie, Dritter Bank, Buch III, Der Gesamtprozess der kapitalistischen Produktion* Berlin: Dietz Verlag 1932, pp. 647-648.) Suzanne de Brunhoff prefers to use the word ‘adapt’ in place of ‘subordinate’ (de Brunhoff *Marx on Money* translated by Maurice J. Goldbloom, with a Preface by Duncan K. Foley, New York: Urizen Books 1976, p. 77).

12. ibid. Parts II and III. An essential guide to the interpretation of these parts was given by Josef Steindl in 'Karl Marx and the Accumulation of Capital' in Steindl *Maturity and Stagnation in American Capitalism* Oxford: Basil Blackwell 1952.
13. Marx *Capital Volume III* pp. 459 and 49.
14. ibid. pp. 491-2. See also S. Clarke *Marx’s Theory of Crisis* Basingstoke: Macmillan 1994.
15. Marx *Capital Volume III*, p. 600-601.
16. Kalecki *Theory of Economic Dynamics* London: George Allen and Unwin 1954, pp. 94-95. Kalecki went on to commend Steindl's treatment of this problem in Steindl ‘Capital Enterprise and Risk’ *Oxford Economic Papers* No. 7, March.1945.
17. Marx and Engels *Selected Correspondence 1846-1895* London: Lawrence and Wishart 1936, p 384.
18. ibid. p. 441.
19. ibid. pp. 478-480.
20. Bukharin *Imperialism and the Accumulation of Capital* New York: Monthly Review Press 1924, pp. 253 and 257.
21. Varga *The Great Crisis* London: Modern Books 1935, p. 21.
22. ibid. pp. 39-47.
23. de Brunhoff 1976, pp. 100-101, emphasis in the original.
24. ibid. p. 118.
25. Marx *Capital Volume III* 1959, pp. 467-9.
26. Minsky *Stabilizing an Unstable Economy* New Haven: Yale University Press, 1986.
27. Polanyi *The Great Transformation* London: Victor Gollancz 1945, p. 283.