RETHINKING MONEY AND FINANCE CAPITAL

by

Richard A. Walker
Department of Geography
University of California
Berkeley, CA 94720
walker@berkeley.edu

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Money is a mysterious thing. One good result of the recent financial crisis is that it has forced us all to look harder at the realm of money and finance, and to catch up with events that had been steaming ahead for the last forty years. Everyone now has at least a passing familiarity with investment banking, derivatives, secondary markets and hedge funds. But simply describing the bubble and meltdown or denouncing the bankers and subprime mortgages won't do; we need to understand what money and finance do, what part they play in the capitalist system. Sadly, leftist and Marxist theorizing about money has always been thin - money has been too repulsive, too ethereal or too far from the point of production to grab our attention – so we on the left are ill-prepared to explain what just happened or what is likely in store for the future.

Moreover, faced with a financial crisis of the first order, we tend to fall back on our base of operations: Marxian crisis theory. Certainly, no Marxist is ever surprised by the periodic implosions of the capitalist economy; indeed, we positively pray for them, as living proof of the system's contradictions. The best work in this regard is that of Bob Brenner (2002, 2004, 2009). He has been nailing down the malfunctioning of the U.S. and world economy for the last twenty years, and has a very clear theory of why things have gone awry. It includes finance, to be sure, but ultimately rests on the failures of 'the real economy': rates of profit, global competition, overproduction, overinvestment, etc.

The problem is that big financial bubbles are rarer than your run-of-the-mill upswing, major financial crises are more profound events than your ordinary recession, and their disastrous effects on economic recovery are legend (Reinhart & Rogoff 2009). Yet if money runs amok from time to time, can that fact be explained by the underlying grinding of the economic gears alone? I think not. The best we have on the left to explain such financial mega-swings is some kind of long wave theory with a twist of stagnation and financial triumphalism, as described in Giovanni Arrighi's *The Long 20th Century* (1994). The lesson is that we need a theory that can account for the somewhat independent movement of financial affairs from the underlying industrial economy.

To do that, we need to go back and rethink our view of money itself, and to use that to rethink Marxist theory – and not so much crisis theory as the basic theory of capital and capitalist development in a way that gives money a real role. I offer a set of 10 propositions about money and capitalism that might provide a framework for a revised theory. My basic axioms are that money has a certain relative autonomy from the so-called real economy, that money has a special place in capitalism, and that money can work its magic both for and against industrial capital. What is more, the power of money and the thirst for money-making regularly rear their heads above the sea of 'capital in general'. In the end, this means that we have to squarely face 'finance capitalism'.

1. Money Matters

Money is essential to daily life. It is something we recognize immediately, but can barely imagine in its totality – like gazing at the starry night sky. It is something we dispense freely but also wish to hold onto, to amass as abstract wealth. It is the purest form of power over things and others, much sought after and yet feared in the hands of others. Money is the great leveler and yet also the root of all evil. At the same time, money is clearly essential to the capitalist economy. It is the fluid coursing through the veins commerce and market exchange. It is the substance of corporate revenues and the measure of profits. It is the stuff of taxation and the lifeblood of governments. It is, above all, the starting point and the end goal of capitalist accumulation.

Nevertheless, in conventional economy theory, money doesn't matter. It is consigned to a purely nominal role, useful for market transactions and measuring prices, but having no real effects on its own (Ingham 2004, ch. 1, Smithin 2003). To the neoclassical economists money is no more than a "veil" over the workings of the "real economy"; pull back the curtain and you'll see only the little wizard of the market operating the modern world economy. In the conventional view, money is tightly harnessed to the real economy, with very little room for independent movement. Money serves commodity exchange, acting as a means of exchange and measure of values (prices). It cannot outgrow the exchanges it serves and the value that it measures.

Both neoclassical theory and Marxist economics normally operate on a hard money theory that goes back to the origins of the gold standard in post-revolutionary Britain, c. 1700. In this "quantity theory" of money, the amount of currency times the rate of turnover should equal the amount needed for circulation to proceed smoothly. If money does outgrow the real rate of expansion of trade, it will trigger inflation and crisis of confidence in the value of money, and will ultimately be brought back to earth (Ingham 2004, pp. 19-23). If this were true, however, it would be hard to explain the intense attention of central bankers and monetary authorities to the flux of money and their careful attempts to manage money in service of overall economic performance. As the brief reign of "monetarism" in the 1980s shows, there is no automatic relation between quantity of money and economic growth and price levels (Ingham 2004, pp. 28-30).

There is a long line of dissenters to the conventional view of money, going back at least to the English Revolution (Ingham 2004, ch. 2). John Maynard Keynes (1930) is the most important of the modern dissenters, and his followers include Hyman Minsky (1986), whose reputation shot up in the wake of the recent financial crisis. For these theorists, money arises outside of the commodity exchange system, and has a life of its own. Indeed, on this score Keynesianism outshines the vast majority of Marxian economics, in which money is taken as a reflection of the economic base of production and circulation of commodities. Orthodox Marxism is not much better than neoclassicism in its disregard for money – though Karl Marx himself had some crucial things to say about money, as we'll see. The latest in the long line of dissenters is Geoff Ingham, whose brilliant monograph, *The Nature of Money,* inspired me to rethink money in Marxist economics. Nonetheless, Ingham and the others still have a lot to learn from Marx, who remains the bedrock theorist of capitalism.

Taking both sides into account, we can say that money is irreducible to the so-called real economy[1], yet it is absolutely necessary to the latter's operations and even arises out of the flux of commerce and production. To see how this dialectic operates, we must go beyond a simple opposition of schools of thought to forge a new synthesis. To begin with, there has to be a recognition of the gap between money and commodities, finance and exchange, and financial sector and industry, and that gap will make an enormous difference in the end. We need to open up the conceptual space to see that gap and then follow up that insight with additional ideas that keep expanding the gap. This is not an arbitrary or simple metaphysical exercise, for money and finance work that tiny gap into a world of difference in the same slow and insidious way as water seeping into a crack will freeze and break open the strongest rock and wear away the highest mountain.

2. Money is Virtual but Real

If money is real and has real effects, then why is it so elusive? Goods and services can be seen, prices can be quoted, but money is sometimes visible and sometimes not. That is because money exists in two modalities: tangible and virtual. In this money is like quanta of energy: both particles and waves at the same time (and just as hard to get our heads around). Tangible means that money takes the form of currency: coins, greenbacks, checks, credit cards. These are things we can see and feel. On the other hand, money is virtual in that it is simply numbers in accounts. In the old days, these were books that could be seen and held, but today they are all digitized in the virtual world of computer clouds. This has led some people to speak of a 'moneyless economy', but that's not true. What we have is a currency-less economy, in which bills and coins issued by governments –hard currency – amounts to less than 1% of all money in circulation.

Money is not just virtual because it's digitized. Money is virtual in the sense of acting as an abstract 'money of account' (Keynes 1930).[2] That is, money is a system of counting, measuring and comparing values of things like stocks of goods, flows of trade, taxes and debts. This was true long before the rise of capitalism and the modern market economy. Money of account grew up from large scale practices of merchant trading and borrowing, assessing wealth of kings and priests, levying taxes and paying soldiers. These required an abstract system of accounting. Indeed, money of account exists as far back as early Mesopotamia, closely tied to the origin of number systems and mathematics (Ingham 2004, pp. 95-99).

Currency (or tangible money), on the other hand, was issued only episodically and pragmatically before modern times, was not always present at the moment of settling

[1] I will continue to use the standard term the 'real economy' as a convenience, even though I am arguing that money and the gap are also real.

[2] Marx also refers to the dual nature of money of account versus hard cash, and the potential contradiction between the two (1967a, p. 138).

accounts, which had to be done in abstract, agreed upon units. Indeed, currencies came to reflect those units of account rather than generating them. Before the modern era, most gold and silver were used as ornament and treasure, symbols of accumulated wealth of kings and emperors. Until the advent of regularized commodity exchange, their value had little to do with markets (Schoenberger 2008, 2010).

Money of account is an abstraction from the everyday expression of prices, currency or wealth. It is what Marx called "a real abstraction" created in the process social life.[3] To put it another way, abstract money of account is like abstract weights and measures, another real and practical abstraction. Both have to be settled upon by merchants, kings, and industrialists, and they have to be enforced, usually by means of the power of the state.

Both ancient empires and modern states have had to back up systems of monetary account and put them into effect by minting tangible currency (coins). States have also been the greatest users of money (to collect taxes and to pay soldiers), keepers of accounts (storing grain or accumulating precious metals), and borrowers from merchants and bankers (to finance wars), and they have thus had a clear interest in counting debts, measuring assets and assuring values in payment.

If money depends as sovereigns, it is, itself, a kind of sovereignty, as Ingham (2004, p. 12) puts it. The abstraction of money means the abstraction, or rather generalization, of a certain power to make things and people move, and possession of money gives people and states power a new kind of power over others that it not reducible to the power of arms or prestige. But this power of money remains limited in pre-modern societies. It only steps forward in a distinctive way in modern, capitalist economies, as we'll see.

In short, money is an abstraction from the nuts and bolts of exchange and production, one that's old and runs deep. It occupies its own realm, cradled by states but carrying its own degree of sovereignty. But money is also tangible and does not just occupy a virtual world of its own; it steps forth in the practical world of economy as money for payment and as stores of wealth that can be put to work. This is especially true in the modern world of markets and capitalism. Modern money starts with credit and debt, then picks up force from the swirl of commodity values, and finally joins forces with capital, as we'll see in the following three sections. As money evolves with the rise of capitalism, so does the gap between money and the real economy and the power of money over economic life, until we finally reach the mystic world of finance today, as we'll see in the later sections of the essay.

[3] That is, money is an abstract relation, not just an abstraction arrived at through thought. To grasp this requires an ontology in which the world has depth and not everything is immediately accessible to observation (Sayer 1987).

3. Money is Created via Credit

Where does money come from? Bourgeois economists from the time of Adam Smith have seen money arising from the natural tendency to truck, barter and trade, using one thing or another as a means to facilitate exchange (conch shells are a favorite example in these just-so stories) (Ingham 2004). Marx, too, speaks of gold and silver arising as just another couple commodities with their own values, which then get adapted to use as money because of their practical qualities (Marx 1967a, p. 90). Neither of these are adequate 'origin stories'. Money has its own sources of creation. Money arises outside commodity circulation and is not rigidly bound to the quantity of goods and payments in the market.

Money is born in the realm of credit and debt: it is a promise to pay, guaranteed by either merchants, bankers or the state (Ingham 2004, pp. 12, 56-57, 69-80). Government currency, whether ancient or modern, is a promise to pay for goods and services, backed by the wealth and taxing power of the state. But the vast majority of money originates not from the state but from the financial system itself, especially commercial banks. Every time banks issue loans, whether in the form of checking account balances or credit card advances, they are creating new money. These acts of lending are, of course, linked to real economic activity as the borrowers use the new money in hand to make consumer purchases (like a new car or home) or to make business purchases, like new stock or equipment.

Credit relations became more regular with birth of the modern era in the relations among merchants in Europe, and for the first time private money overtook state money in quantity and quality. Here again, abstract money of account was crucial in order to keep track of debts, payments and stocks, even where no hard currency changed hands. The invention of modern bookkeeping and banking in Renaissance Italy was no accident, and it anticipated the generalized commodity production system by at least a century. The real key to an expanding money supply, however, was commercial borrowing and lending through merchant IOUs (or bills of exchange). Another major step was the "depersonalization of debt" in exchanges of these bills, as took place in Antwerp and then Amsterdam and London in the 16th and 17th centuries (Ingham 2004, pp. 108, 112-20).[4]

Government debt in the form of bonds (like U.S. Treasury Bills) is another kind of promise to pay, which is monetized as it circulates through banks and exchanges. Government bonds are sold to wealthy individuals or funds, private banks or to the central bank (e.g., the Federal Reserve), allowing the state to turn around and spend by writing checks (either its own, the central banks or the private banks). The modern state manipulates the amount of money in circulation by having the central bank buy or sell bonds, by reserve requirements for commercial banks and by having the central bank provide credit to the banks to expand their reserves.

[4] Harvey (1982) draws on scattered observations by Marx, particularly in volume III of *Capital*, to arrive at a similar history of credit as Ingham.

Another big step in the evolution of modern money was the founding of the Bank of England (1697), which turned the king's personal debt into public debt, which circulated as official bills issued by the bank. Coinage was also regularized at the same time by Sir Isaac Newton and other Ministers of the Exchequer. Britain thereby created the first unified, dual monetary system, linking hard and soft currency, virtual and real money (Ingham 2004, pp. 121-29).[5] Money in the United States remained cacophonous until the mid-19th century, thanks to the demise of the first two national banks and freewheeling state banking; the California gold and silver rushes, Civil War greenbacks and postwar nationally-chartered banks smoothed things out gradually from 1850 onward (Studenski 1963).

The power to create money is a critical one, and the history of money is fraught with class struggles. Bankers worry about inflation, or the overproduction and subsequent devaluation of money, and the instability it brings to all monetary calculation and erosion of monetary wealth (their wealth!). Serious inflation has happened in many times and places, even in the United States, as in the free-wheeling days of the state banks in the 1830s or the easy-money decade of the 1970s (Studenski 1963). Conversely, there is a lively history of popular movements to extend credit and money supply to their advantage, as in the Populist upheaval of the late 19th century, when the cry of 'Free Silver' went up from the farmers and merchants of the west and south.

Today the credit system is so extended that it's quite hard to pin down where money begins and ends. Indeed, even the monetary authorities have trouble saying what the total quantity of money is today! They have a system of categories, M1, M2, M3...M10 and beyond, each less tangible and more virtual than the last, and still no one is sure if the measures are right. This is not to say there's no determination at all, only that it can never be precise – precisely because of the gap between tangible and virtual money and that between money and the real economy. This elasticity of money, and the open-ended potential of money creation, will have particular importance when it is joined to capital, as we'll see below. But it is not infinite in its abstraction. Money must still be tied back to value creation in the market economy.

4. Value Breeds Money

Money is very old, but it took on a dramatically new form and function with the coming of the modern capitalist economy. In the early modern era, beginning in the 15th century, money stepped forth from its cocoon in ancient states, ruling classes and trading systems (Schoenberger 2008). It began to strut and fret upon the world stage in its modern role as crown prince of the market and commerce, then extending their sway across Europe and bringing more and more economic activity under their suzerainty. This process grew by leaps and bounds with the European conquest of the New World (Moore 2003, 2007). A new age had dawned, that of 'general commodity circulation', as Marx (1967, ch. 1) called it (or what bourgeois economists call 'the market system').

[5] Though bills of exchange and local coinage continued to circulate into the 19th century in Britain.

Early modern Europe saw gold and silver monies start to flow through the arteries of commerce in unprecedented quantities. Indeed, as Erica Schoenberger (2010) has shown, this is the first time in history that gold becomes primarily money in use rather than stocks of wealth measuring the social value of kings and nobles. The fetish form of this earth-shaking transition from royal money to economic money was the plunder and accumulation of gold and silver stocks, chiefly by the Spanish empire in its conquest of the Americas (something approved of by 'mercantilist' economy theory). As Marx puts its, "Modern society...greets gold as its holy grail, as the glittering incarnation of the very principle of its own life" (1967a, p. 133). But this fetish could not sustain real economies, as the Spanish discovered to their regret in the long 17th century (Hobsbawm 1954).

In its new role as key actor in the play of commerce, money solidified its modern role as means of exchange, measure of value and store of value. But what is this thing "value" that money is supposed to be the measure and store of? As Marx has argued, with the spread of markets as regulators of economic life, a new kind of abstraction arises in the world: commodity value. This, too, is a 'real abstraction' in Marx's terms (Harvey 1982), but Marx was hardly alone in thinking that market prices were the surface appearance of something deeper. All the classical political economists, from Macpherson to Adam Smith, explained value in terms of the average labor time embodied in goods (in opposition to the agricultural theory of value of the Physiocrats)(McNally 1988). In an age of artisanal labor in the 17th and 18th centuries, this was an eminently reasonable proposition. Labor value theory would later be eclipsed, but this is not the place to elaborate on that.[6]

As value becomes the chief moving force behind exchange and commodity circulation, it drives the expanding use of money. As Marx says early in *Capital,* "circulation sweats money from every pore" (1967a, p. 113), and that money represents value. As production expands, the swirl of commodities expands, and so does the quantity of value in circulation and hence the amount of money. So here we have a collision of two sources of money: modern credit money in merchant bills and commodity values requiring expanded means of exchange and stores of value in a money form.

In either case, money does not just take the form of tangible currency; it still exists primarily as money of account, or abstract money. But a crucial transformation takes place: the modern abstraction of commodity value comes to inhabit the older abstraction of money of account. Ingham fails to reckon with this historic transformation because he has refuses to continence a theory of value (2004, p. 62). Rather, for him money is chiefly guided by credit relations and by states, not the production and circulation of

[6] With the industrial revolution (which hit just as Smith (1776) was writing *The Wealth of Nations*) simple labor was joined by a growing mass of machinery *qua* capital, and by Marx's time it had become hard to sustain a simple labor theory of value because of the what Marx called 'the transformation problem' (unequal capital/labor ratios across sectors). There have been endless quarrels over the usefulness of labor value ever since. Neoclassical economics threw the labor theory overboard and replaced it with a purely nominal measure of utility. Nonetheless, a material theory of value is essential to any real understanding of production, exchange and exploitation, and even in neoclassical models price equal marginal *cost*, a real quantity, an equilibrium – so they're theory of value is by no means simply nominal.

commodities. On the other hand, Marx and his followers have erred in thinking that the commodity value system and the money system are equivalent. There is no such equivalence; on this point Ingham is correct. Money of account comes into alignment with money as value, to be sure, but it is never simply reducible to the sum of (labor) value produced.[7]

Money is more like a glove fitted to the mold of value production and circulation. Or to revert to my earlier metaphor, money is not a lubricant, it is transmission fluid. We do well to leave mechanical metaphors of hard gears behind and replace them with softer metaphors like gloves, automatic transmissions or electric transformers. One Marxist economist who seems to have grasped the unique quality of money as a sort of elastic membrane for value is Alan Freeman (1995), in dealing with the impossibility of static solutions to the so-called transformation problem (see previous footnote). Our theory-guiding metaphors must continue to mind the gap between money and the real economy in this sort of elastic way if we are to understand how the financial sector can drift so far away from the real economy.

But there is more to the link between money and value than elasticity. Value is the iron fist is the rubber glove of money. It gives new life, new currency and new force to money, with a new and broad power of money over things and people and even states. And that power is further extended by the way money comes to ride the elephant of capital, even as money becomes part of the life force of capital, in turn.

5. Money Breeds Capital

It takes more than market economics and value theory to grasp the workings of capitalism. Capital is the vital yeast in the brew. I have always thought that Marxists read too quickly over the opening chapters of *Capital* to get to the secret of surplus value and the nitty-gritty of the labor process. In fact, chapters 3 and 4 of Volume I are vital to Marx's whole project. These are the bridge between the opening chapter showing that commodity value is based on socially necessary labor time and chapter 6 and 7 showing that surplus value is surplus labor time. In these bridging chapters, Marx demonstrates that generalized commodity circulation must *necessarily* give rise to the use of money as capital. This is the real game-changer, historically speaking.

Looking back, as commerce became generalized in Europe and the Americas, so did capital, but with a bit of a lag. The merchants of Italy who financed the Iberian conquests of the 16th century, with the help of the barely-modern Spanish and Portuguese crowns, were still shadowy players compared to the Dutch and English merchant capitalists who drove the sugar and slave trade of the West Indies by the 17th century, aided by the modern Netherlands and British states that they had shaped from within (Arrighi 1994, Moore 2007). And, of course, by the 18th century, full-blown capital gave birth to the agrarian and industrial revolutions in Britain, spreading quickly across Europe and to

[7] On the other hand, Minsky (1986) surely goes too far in calling money a 'force of production.' Money is a force, to be sure, but production (of value) is something else again.

North America (Marx 1967a, Pollard 1981). How to understand this movement theoretically?

Marx's argument is that generalized market exchange requires money as means of exchange and measure of value, as in the formula C-M-C; but it also bleeds new money that serves as a store of value and the stalking horse of capital.[8] C-M-C soon becomes inverted to M-C-M', as merchants see that money thrown into circulation can yield more money, i.e., make a profit (Marx 1967a, pp. 147-50). Soon this becomes the preferred pathway of money: not as a passive facilitator of exchange but as an active investor in circulation (merchant capital) and, ultimately, in commodity production (industrial capital). The secret of profit making, or the ability of M to turn into M', is revealed by Marx to rest on the secret of surplus value: labor's ability to produce more value than it costs to reproduce workers.

Everyone leaps on the production of surplus value as the key to the life of capital, but Marx does more in the early chapters of *Capital.* He reveals the secret of capital accumulation – the engine of modern economic growth. This secret lies in the nature of money. Money, which is pure value, pure accounting, is *potentially* infinite, and thus capital accumulation, too, might be infinite – even if the number of commodities, "the wealth of nations", is not. Thus, the lust for unlimited monetary wealth becomes the first motivation of the capitalist – NOT competition, as usually thought, which enters the discussion much later in volume I and volume III. Marx's key discussion of the miser versus the capitalist reveals that the world of the monied is turned upside down once the possibility of unlimited accumulation through investment, rather than hoarding, opens up (Marx 1967a, pp. 130-33, 151-53).

Indeed, the accumulation of capital opens up a new gap between the abstract and infinite world of money and the foundations of commodity production. Capital climbs atop the economic bandstand and everything else is soon dancing to the tune of M-C-M'. Capital becomes the reigning power over economic life (unlike the kings and emperors of old). This brilliant insight illuminates all of *Capital*, with capital begetting more capital, more wage-labor and more surplus value, *ad infinitum*. It is an insight wholly lacking in orthodox economics. Unfortunately, it is also barely visible in Keynes and in the post-Keynesian monetary theory of Galbraith, Minsky and Ingham, as well. So, while the dissident money theorists are right to recognize the autonomous life and power of money, they fail to see that capital multiplies the power of money exponentially in the modern world, and continues to do so.

Alas, in Marxist theory it is industrial capital that gets all the attention, while money fades into the background. Money virtually disappears in the second half of Volume I of *Capital*. When Marx goes on to discuss capital circulation in Volume II, the peculiarity of money is hardly mentioned (Marx 1967b). Money only comes back when he discusses the partition of total surplus value in Volume III. This is not satisfactory.

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[8] "This final product of the circulation of commodities is the first form in which capital appears". Marx 1967a, p. 146.

6. Money Amplifies Accumulation

Credit does not just create money, it creates money that can serve as capital – an essential function of money in the capitalist economy. Credit-money expands the quantity of capital and amplifies the rate at which capitalists can invest and accumulate. In the process, credit capital does something more: it accelerates the race of capital into the future. It does this in much the same way as it does for home-buyers, who can have their house now without waiting for years to save enough to buy such a large item.[9] Money thus serves as a kind of soy-extender or catalyst of capital accumulation.

To grasp this power of credit to capture the future, we need to understand the way capital operates. It does not just take past savings and then spend them on known operations, it invests in new factories and technologies in hopes of making a profit in the future. Capital investment is always speculative, in the sense we can never know the future. There is no hard and fast line between real investment and speculation, as David Harvey (1982) has argued. Capital's willingness to take the risk of investment is its strength. Capitalists jump into the future void with glee and make things happen; they realize value before its time.[10] Hence capital's claim to produce not just today's prosperity, but to bring 'progress' in general through technical change and to deliver 'the future' today. These promises are two pillars of bourgeois ideology that run deep in the American social psyche.

Credit is thus essential to capitalist profit-making and to the growth of the capitalist economy. But did the new money create the new profit or did that profit come from real surplus value generated by the capital investment and employment of labor? It's both. There's a chicken and egg problem here of the interplay of the monetary system and the real economy, but if production is the egg, money is surely the sperm. Sperm may not look like they do much in reproduction, but they need to be present at the offing. And the magical zygote here is credit-money acting as new capital with the power to expand production beyond existing limits and hence to create new value and surplus value. This is certainly what Keynes (1936) had in mind when talking about the real effects of money and finance on aggregate economic recovery and growth.

Marx calls credit-generated capital 'fictitious capital', because it is new capital that can only be realized gradually over time, and thus made 'real'. Harvey (1982) makes a careful analysis of fictitious capital and its relation to the creation of fixed capital that lasts over several cycles of production. He shows that Marx's terminology is useful in that it captures the futurism and uncertainly of investment. But Marx and Harvey's use of the term is misleading in that it makes new credit-money appear to be fictive when it is all-too-real, whether or not the capital investment succeeds. Money has the magical power

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[9] There is a lively debate over just how much external finance most large corporations need; in good times, it is actually very little (Galbraith 1967, Henwood 1997). But small firms always need finance, and some of those will become large over time, and even large firms make forays into financial markets from time to time.

[10] As was understood by Keynes (1936) in his discussion of the 'animal spirits' of the capitalists. I get the phrase value before its time from Randy Martin.

to multiply itself, which it lends to capital for its own purposes of expansion in production.

Of course, this is a tricky matter of balance, as Harvey is well aware: if the fictitious capital expands too rapidly with respect to the production of surplus value, overaccumulation results and profit rates will fall. The potential gap between fictitious capital and real returns can open up and swallow prosperity in a financial crisis. These real effects of overenthusiastic financing and money creation are all too apparent when financial bubbles burst as in 2008, paving the way for the Great Recession.

So now we have money giving rise to capital and helping to drive capital accumulation. But is this all there is: money as the handmaiden of capital? Now we have to turn things around and see how capital infects money and gives rise to finance capital.

7. Capital Breeds Finance Capital

Marxists are quick to dismiss the foolishness of quick-buck capitalists and speculators who try to make money out of money, without the bother of actually making products – i.e., the short-circuit of accumulation, M-M'. Marx introduces the short-circuit early in *Capital*, but goes on to look in depth at the full circuit, with only passing reference to M-M' in moments of crisis. This won't do. From the capitalist point of view, this kind of quick and easy money is just as good as producing stuff – even better. As we've seen, money really does breed money out of itself via credit; so why not accumulate by means of monetary investment? There is, once again, a gap between money as passive reflection of the underlying economy and money as an active force – for making more money.

Just as, in the first instance, money becomes capital, imparting its infinite nature to accumulation, the spirit of capital subsequently comes to inhabit the world of money, with the holders of money eager to take up the banner of capital accumulation. That is, from being merely money-lenders, the owners of money join in the systematic process of investment, extraction of surplus value, and pursuit of self-expansion. But they don't just turn into industrial capitalists: they become finance capitalists. They may lend to industry (as we'll see below), but why should they bother with the full circuit of industrial capital when M-M' is ever so much quicker than toiling the long route through M-C-P-C'-M'?

All the evidence shows that financiers are in eager pursuit of surplus value from the real economy, just like other capitalists. They throw their money into circulation and expect to make a profit, and they expect to repeat the process over and over in a spiral of accumulation. Marx was well aware over the way finance elaborates the credit system in order to make money for itself, but those insights of Volume III have rarely been taken up. Rudolph Hilferding (1919) has a prescient discussion of financialization and its profits, but his work had little impact.[11] Paul Sweezy and Harry Magdoff (1987) were persistent voices arguing that financiers have their own reasons for expanding the financial sector and extracting every last ounce of surplus they can (cf. Foster & Magdoff

[11] Thanks to Rakesh Bhandari for calling this to my attention.

2009). Minsky (1986), of course, well understood the autonomous pursuit of profit by financiers, as have several recent commentators (Phillips 2009, Stiglitz?).

Finance capitalists are forever figuring out new ways to work the magic of money, as witness the contemporary revolution in finance. Securitization, derivatives and hedges are all ways of making fast money for the financiers, and in the great bubbles of the 1980s, 1990s and 2000s, money was able to breed more of itself at a brisk pace and financiers made a killing off the financial frenzy, with bankers walking away with billions.

Finance capital requires people to enact its functions, firms to contain their money, employees and expertise, and market channels along which their money can flow. The money system therefore becomes institutionalized in things like banks, capital markets and equity funds, or what is commonly known as the financial sector. Commercial banks are the essential infrastructure of the money system in the capitalist economy – like electricity grids or water pipes – and have been for centuries. Banks are everywhere, with their branches and ATMs acting like faucets for the money system. Behind the commercial banks lie the specialized traders, equity managers, hedge fund operators and the rest who operate in the world of securities, or what are usually called 'capital markets'.

The institutional formalization of the gap between money and the real economy is represented by the clear separation of the 'financial sector' from the rest of industry and commerce. The financial sector is often treated in popular discourse and economics as if it were just another line of industry, but of course it's not. It is a world apart, even if deeply inter-digitated with the real economy (Minsky 1986). Finance capital is what used to be called 'the monied interest'. Of course, the institutions and the whole apparatus of finance, and its purposes, are socially constructed, as Karen Ho (2009) argues, but the players of finance are also the bearers of the power of money and of capital, those vital and real social abstractions.[12]

So how does money work its magic and bridge this gap between M and M'? In various comments in Volume III of *Capital,* Marx seems to rage against the ever more elaborate ways that finance hides the secret of surplus value deeper and deeper from public view. Here is the money-economy gap again and money drawing a veil over the real economy. We need to pull back that veil and enter this hidden abode of money to seek out the secrets of monetary power and profit.

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[12] The power of money and finance capital is also the power to move governments and states. This power is not absolute, but positional, allowing the two to fight it out. This is one of the oldest themes in modern life: the dance of the financiers and the kings in early modern Europe or the dance of the bankers and president today. Sometimes one screws the other, as the Hapsburgs did to the Fuggers, but it can go the other way, as in present-day Ireland, where the bankers foolishness brought down the Fianna Fail government. It's clear that the Wall Street boys have their tentacles around both Democratic and Republican administrations in Washington, not to mention in key states like New York and California (Johnson & Kwak 2010). But the power of finance is also to so alter the practical and intellectual terrain that the state and its handlers are forced to adapt to the change, and to take the present state of (im)balance as the new norm (Galbraith 1988, Fox 2009).

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8. Finance Takes Its Cut

Some of what the bankers walked off with during the bubble were certainly ill-gotten gains, filched from the real economy and the working class. To understand such filching, we need to grapple with *monetary exploitation*. That is, money itself can charge for its 'services', most typically the loan, and extract a return -- regardless of whether the money does anything productive at all. The loan may be used for consumption or it may be wasted, but it must still be paid off and then some. Obviously, money in this sense is not a passive representation of value, nor is it just industrial capital circulating normally. It is finance actively asserting itself in the real economy and getting paid for its effort. M gets its M' just for being there.

The foundation of monetary exploitation is "interest", or the return on loans. Those with money (creditors) lend to those without, and they expect to be paid back with interest by those in need of money (borrowers). Interest is money's rightful payment for its use. This was true long before generalized market exchange, when interest rates were notoriously high (the notorious 'pound of flesh' in Shakespeare). With the rise of capitalism, borrowing and lending became more regularized and interest rates more reasonable. A market in loans arises, albeit imperfect, and begins to set the rate of interest between lenders and borrowers. But the rate of interest remains positive, and a goodly source of income to money-holders and lenders. That positive return fills the gap between M and M'.

Interest is a cut of the total surplus value. It is one of the three main forms of extraction of the surplus that Marx outlines in Volume III of *Capital*: interest on money, profit on enterprise and rent of land (Marx 1967c). As money-lending evolves into a portion of capitalist activity, finance capital exploits labor not just directly in production but indirectly through consumer loans. Finance capital lends to industrial and commercial capitalists, as well, and the latter are forced to turn over some of the surplus they extract to the bankers as interest. Financiers also happily lend to small producers, such as farmers, and small merchants (retailers) in need of mortgage and commercial loans. Finance thus extracts surplus value via the realm of circulation rather than at the point of production (Roemer 1982).

There is a vital history of popular resistance to the extraction of interest by financiers. In the United States, it goes back to the Jeffersonian and Jacksonian eras and resistance to the creation of a national bank. Populists wanted liberal banking rules (and state banks), so that money would be easily available on the frontiers of American growth and inflation would lessen their debt load. In the 20th century, popular power demanded that states put caps on interest rates through so-called usury laws, which were only set aside recently (Studenski 1963, Whalen 2010).

This history raises the question of how big a cut of the total surplus value should go to the money-lenders. Neoclassical economists say that interest is set by the demand and supply of money, which ultimately says nothing: what establishes supply and demand? Since Wicksell, some economists have sought to establish a 'natural rate' of interest, beyond political determination. Some Keynesians have similarly said that the natural rate of interest is equal to the natural rate of growth, set by population and technology; but this assumes that the development of labor supply and technology are independent of capital and the rate of accumulation – a very curious assumption in the modern economy.

Marx seems ambivalent about what determines the rate of interest. In one place he says it is supply and demand of money (1967b, p. xx). In another he implies that interest approaches the rate of profit on enterprise (p. xx). But isn't interest more like rent than profit on enterprise? Surely, if there's something like "absolute rent", there must be "absolute interest" below which no self-respecting capitalist will lend? The rate of interest may fluctuate around a market price, or general rate of profit, but the market (supply and demand) is always a place of struggle, or as Marx puts it in discussing the wage-rate, "Between equal rights, force decides" (1967a, p. 235). So, too, must it be for the rate of interest.

Ingham (2004, p. 92) argues that some of the most important class struggles in history are between debtors and creditors. And in our times, the evidence is that the financiers have been winning this struggle quite handily (Harvey 2005, Frank 2000).

Interest is not the only source of monetary exploitation, or extraction of surplus value from the real economy. Financiers like to charge people and business for a raft of 'financial products' and 'financial services'. But it's by no means clear what financial products and services are.

The chief financial product is, of course, money itself. That is, banks make loans, for which they not only charge interest but 'origination fees' and other such tricks. But money is not a product; it is not a good or service; it is not a commodity of any kind. Money is money. So calling a loan a 'financial product' is just verbal sleight of hand.

The main financial service is handling money. The simplest form is a savings or checking account for depositing and withdrawing cash. Banks invent all kinds of fees for the modest capital and labor cost of keeping your accounts, running ATMs, but here again the rate of fee is quite flexible and after a crash like 2008, all sorts of new fees and higher rates went into effect on ordinary bank accounts. Another form of labor-service is investment assistance for those with large savings, or what used to be the business of 'trust departments' of banks but now resides with all kinds of mutual funds, equity funds and the like. Again, there's no tangible product, but the financiers' labor takes a commodity form and comes at a price limited only by competition and the power of the wealthy investors.

The only real financial product is the financial asset, or the thing that financial investors buy with their money. But that takes us beyond the realm of interest and fees, and it deserves its own treatment in the next section.

9. Finance Capital's Parallel Universe

The only true financial product is a financial asset. A financial asset is a curious thing; it is not a real asset, but a title to a real asset and/or the right to collect an income stream from an asset. Such assets can be hard capital, like a factory or apartment building, for which one buys a deed (real estate); or they can equity shares in public corporations (stocks), which usually offer a payment stream called dividends; or they can be a firm itself. Assets can also be financial in origin: bank loans or bonds (basic forms of credit) from which interest payments are expected, insurance policies for which regular payments are due, or xxx?.[13] Financial assets are commonly called 'securities' – a realm that has outgrown banking since 1970 (Phillips 2009) – and they occupy a kind of parallel universe to the real economy.

Financial assets are sources of income and stores of value. They can be bought and sold and be priced. Investors can put their capital into such assets in hopes of a profit, either from the payments flow or from a rise in prices (asset values). Investment in such assets is the main activity of the securities sector, and it offers good returns -- sometimes startling returns from rising asset values in an asset bubble. One might dismiss all the wheeling and dealing in securities, or capital markets, and the resulting profits as irrelevant to the operation of the real economy, but that would be a mistake.

Financial assets and markets have several functions. First, they generate new credit-money for capital investment in the real economy: when stock and bonds are first issued, they are like loans from buyers to companies (or governments). This is fruitful money, although it extracts its pound of flesh in interest and fees. But the amount of real credit-creation in capital markets is small relative to the size of the financial sector (Henwood 1997).

Second, financial assets are a way for finance capitalists to get their hands on income streams from loans, insurance and other obligations of households, businesses or governments, whether mortgages, students loans, health insurance or government debt (Bryan & Rafferty 2006). This is another avenue for money and finance to exploit labor indirectly in the realm of consumption, through housing, education and health care; or indirectly out of business profits going to pay dividends, pay off bonds or liquidate real assets; or through the taxes that allow governments to pay their debts. It has often been remarked that the 'financialization' of income streams has been markedly extended over the last generation (Martin 2002).

Third, financial assets generate new wealth through rising asset values. Rising financial asset values jump out in any discussion of contemporary finance and financial bubbles, when asset markets take on a dynamic of their own. This was true in the stock bubble of

[13] Banks count their loans as assets, but they only become financial assets in the sense used here when such loans are sold in secondary markets. I'm not going to get into options, futures, calls and other derivatives, and even more exotic vehicles.

the 1990s and the housing bubble of the 2000s (Reinhart & Rogoff 2009, Shiller 2005). Not surprisingly, financial capitalists are commonly obsessed with the possibility of rising asset values and they are happy to help things along by extending credit to investors to buy purely financial assets. Debt-financed financial investment is a key sign of financial bubbles (Galbraith 1988, Kindleberger 2000).

Fourth, asset markets are supposed to allow capital to shift between categories of investment, maintaining liquidity, and to buffer investment risk by providing a continuous assessment of the value and credit-worthiness of households, companies and governments. This is particularly true of derivatives, which are bets on the behavior of asset prices and returns, and what is known as 'hedging', or betting against the dominant flow of markets. A whole new world arose of secondary markets in securities, tertiary markets in derivatives, and quaternary markets in hedging and insurance contracts. Many critics think that capital markets (and especially derivatives) do more to exaggerate risk than to hedge and dampen it, however, and the record of the 2000s certainly supports this view (Bryan & Rafferty 2006, Fox 2009).

Are rising asset values just funny money, mere virtual wealth, or are they real? Clearly, asset bubbles can evaporate away at any time if they outrun a reasonable relationship to the growth of the real economy, as they did by the trillions of dollars in the last couple financial crises. But rising asset values also represent real wealth and have real effects. One way we know such values are real money is that they appear on the Fed's list as the higher forms of M; this kind of money may be far from the familiar greenback or credit card, but it's money just the same. Another way we know it's real is that rising asset values make asset holders feel richer, and they spend accordingly both for investment or consumption. This is what Bob Brenner (2002) calls 'stock-market Keynesianism'. As Keynes first pointed out, the government could create new money to stimulate the real economy and thereby create real commodities, technologies and profits. Just as monetary Keynesianism or military Keynesianism can work under the right conditions, so, too, can financial asset Keynesianism.

What is just as surprising is the fact that despite the subsequent deflation of asset values, the financial world has not gone back to square 1, as it did after the Great Depression or even in the early 1970s. A whole lot of supposedly fictitious asset values are still holding their ground, as in the stock market today, and they feel mighty real and the source of real grievance as financial capitalists continue to cash in while millions of workers remain unemployed in the Great Recession. The gap between the virtual and the real has become a gap between this kind of financial wealth and the impoverishment of large swaths of the working class and decline of industrial capital in the United States.

10. Finance Capitalism: A Logical Outcome?

Almost every critical observer of capitalism would agree that the financial sector and financial activity blew up into a bubble of epoch proportion in the 2000s, one that imploded dramatically and publically in 2007-08. There are many clear indices of the unusual financial bloat. One is the enormous rise in total debt, which ballooned out of proportion to real economic growth. All this lending took place even though lenders/creditors upped the real interest rate, making borrowing more costly to almost everyone. And we all know about the myriad banking fees and usurious rates of credit-card interest everyone pays today. Activity in the asset markets was even more striking, with rising asset values drawing in everyone with money to invest, including a lot of small savers who lost their shirts and even sober professionals who should have known better. The money market funds, mutual funds, small cap-emerging market funds, and all the rest offered great temptation, and sucked money right out of ordinary bank accounts, pockets and houses, which the financiers could play with (Fraser 2005, Lewis 2010).

These facts raise a critical question of balance in the overall economy and whether the financial sector can become bloated out of proportion to its useful functions. Our leading Marxist theorists have a clear view of the matter. Harvey (2010) argues that this was a classic case of finance outrunning the realization of surplus value in the industrial circuits of capital, reflecting the growing lack of investment outlets for the growing mass of capital in the world (xx). Brenner (2009) says that the primary cause of growing debt was a vain attempt to stimulate a low-performing American economy, which since the 1970s has suffered poor average profit rates, weaker growth of output and productivity, and stagnant average wages. Financial theorists, on the other hand, recognize that a financial bubble of the scale just witnessed is an unusual events occurring perhaps two or three times per century (Reinhart & Rogoff 2009). Arrighi (1994) falls somewhere between the two schools.

The rising power of finance capital in our time raises the specter of 'finance capitalism' in the sense of Hilferding and Hobson at the dawn of the 20th century. The last quarter century or more contrasts sharply with the Golden Age of the postwar era, when growth rates were higher, interest rates lower, debt more modest and financial institutions like stock markets much quieter. It has frequently been observed that the financial sector has grown enormously since the 1970s, roughly corresponding to the era of securitization and burgeoning of financial markets (Phillips 2009, Stiglitz 2010). The capitalization of financial corporations has grown markedly in relation to all U.S. corporations, from 12 to 28% (sic), and the share of corporate profits going to finance capital is even higher.

One could defend financial capitalism as a brave new world of global capital management and a buffer against risk in an uncertain world. The capitalists are not unaware of the blinding glare of the future always in their eyes. The bright young stars of financial innovation and economic theorists both took up the challenge of eliminating risk, and risk management became the brass ring of financial capital (Bernstein 1996). Nonetheless, the implosion of 2008 indicates that the risk avoidance function of financial markets, derivatives and hedging did not work very well (Roubini & Mihm 2010, Akerlof & Shiller 2009, Stiglitz 2010). But was the financial bubble nothing more than a phony financial soufflé that fell?

Should we really be surprised at the growth of finance capital? Perhaps this is the natural course of capitalist development. We must remember, first, that money is not a veil, not a reflection and not even just a representation of the value produced in the real economy; money has a (virtual) life of its own. It is the power of the soufflé to rise seemingly on air -- and stand firm. Yes, money cannot whip up economic growth and profits from nothing. The eggs and flour and leaven must all be there. If the real economy is weak, there's only so high that the towers of finance can go, even if they give the weakling a useful jolt from time to time. But the logic of monetary growth is inescapable, as the credit system proliferates. And the power of finance to wax fat on every possible flow of capital, income and surplus is considerable. Finally, the ability of finance to whip up more and more assets and derivatives of assets seems limitless.

How far can finance capital pushed open the gap between money and economy so far, filling the space with its own institutions, activities, investments and profiteering, that we are in a new era of capitalism – and one that is taking the United States downhill? Is finance capital a gigantic parasitic growth on the real economy which, like mistletoe, seems to green up the tree but will eventually kill the host? Whatever we may think of the usefulness of the financial bubble for the real economy, the financial capitalists themselves had no problem with it. All too many of them walked away with real money in their pockets, regardless of the outcome for everyone else. And while the financiers of Goldman Sachs, AIG and Greenwich, Connecticut, could not possibly deliver on the utopian promise of risk-free capitalism, one cannot just write off the whole fantastic apparatus. Something important has taken place, and it's still there despite the meltdown and a certain shrinkage. Capitalist finance has undergone an irreversible shift, one which we only vaguely comprehend – but dismiss at our peril.

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