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The Essence and the Appearance of Globalization: The Rise of Finance Capital

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The Conventional Wisdom

The pundits and ideologues of capital have a story to tell and repeat it early and often. The world economy has entered a new period, in which new rules apply derived from the economics of the pre-Keynesian period. Indeed, whatever insights Keynes might have had, they have been swept into the dustbin of history, along with those of others who argued for reforms of capitalism; needless to say, the radical critics of capitalism are no more than an intellectual curiosity, rather like Ptolemaic astronomers and medieval alchemists.

The story derives from the premise that the countries of the world are now integrated through trade and capital flows to an extent that national economic policy is ineffective in as far as it does not follow a common set of highly restricted policies; those who deviate from that set of policies can anticipate swift and terrible punishment by the impersonal discipline of 'markets', most notably 'the financial markets'. This situation has occurred through an inevitable process which governments, and political 'actors' in general, can no more change than the English monarch of the Dark Ages could prevent the tides of the North Sea from rolling in. It is fortunate, therefore, that the process is desirable as well as inevitable. The globalization of markets will increase the efficiency of resource allocation. As a result, growth will be more rapid throughout the world (and the more rapidly that governments accept the new policy rules the quicker will their

countries gain).¹ Consumers will gain from cheaper prices (the welfare gains from realizing comparative advantage in trade); workers will gain from more rapidly rising wages;² and all, including the poor, will gain from faster growth.³

While it appears that the new policy rules restrict the options of governments to pursue economic and social goals, in fact they represent ‘best practice’ policy which governments should undertake in any case. In other words, the new policy rules have the outstanding benefit of restricting governments to ‘sound’ and ‘realistic’ macroeconomic practice. Further, the rules are straight-forward, and easily understood and implemented: near zero fiscal deficits to reduce ‘crowding out’ of private investment; tight monetary policy to keep inflation in the low single digits and maintain strongly positive interest rates (to encourage saving and attract short-term capital flows); and a competitive exchange rate to bring about optimal ‘open-ness’ of economies.⁴

In what follows, it is first argued that there is little evidence for the quantitative changes in international economic integration upon which the globalisation thesis is based. This prompts the conclusion that the hypothesized process is not inevitable. Major changes have occurred in the international economic system over the last twenty years; they reflect changes in policy, not inexorable trends. There follows a critique of the theoretical arguments underlying the globalization thesis, especially with regard to the ‘best practice’ macro rules. Having made an empirical and theoretical critique, we present an alternative analytical framework for understanding the world economy. We argue that the last twenty years, as a result of conscious and purposeful policies, have fostered a growing hegemony of finance capital over productive capital. This change has accentuated the irrational and unproductive aspects of the circulation of capital. As a result, at the end of the twentieth century, capital can be considered to have ‘run its course’, not in a teleological sense, but in the sense that it is manifesting its most

¹ See World Bank 1996a, especially the box entitled ‘The faster and higher the integration, the greater the growth’ (p. 26).

² This assertion is found in the *World Development Report* entitled ‘Workers in a Changing World’ (World Bank 1995).

³ The argument that the new policy rules foster poverty reduction is made by Demery & Squire (1996), in defense of World Bank programs.

irrational and destructive tendencies. This process can be reversed, for it has resulted from policies which have liberated capital from controls by society.

Myths and Realities of ‘Globalization’

The globalization thesis maintains that the world economy has entered a new era, which one can date roughly from the mid-1980s.⁵ Several alleged ‘mega-changes’ set this new era apart (Yergin and Stanislaw 1998). First, throughout the world economies are more open and trade is substantially more important than in previous eras. This has several consequences: consumption patterns are increasingly international, economic growth is increasingly ‘export-driven’, and national markets are linked. Second, foreign investment has dramatically increased in importance, to become the vehicle of technology transfer and the ‘engine’ of growth. Third, capital flows dominate trade flows, such that the short term movement of capital is an inexorable disciplining force on government economic policies. In this section, the first two hypotheses are considered, while the third is treated in the analytical discussion of productive and financial capital.

Central to the globalization hypothesis is the allegation that international trade has expanded dramatically, such that the term ‘domestic’ market has become almost an oxymoron. If true, this would be both evidence of the era and a major vehicle by which the benefits associated with the new era are realized. A casual inspection of international statistics reveals that international trade in the 1990s was a higher proportion of world output than in previous decades. However, this in itself does not support the ‘new era’ argument, since trade has grown faster than output in every decade since the end of the Second World War. This increased trade has been associated with concrete national and international policies, including the various agreements within the framework of the

⁴ These Golden Rules of macro policy can be found in many publications of the international financial institutions. For a particularly clear statement see the 1992 World Bank report on structural adjustment lending (World Bank 1992).

⁵ Like for all ‘epochs’, the dating of the ‘globalization era’ is difficult to pin down. A reading of the literature indicates that no one dates it prior to 1980, and no one later than 1990. A compromise position is taken here, by dating from 1985. This has the empirical advantage of excluding the most catastrophic years of the debt crisis.

General Agreement on Tariffs and Trade (GATT) and the progressive economic integration of the Western European countries. In support of the ‘new era’ hypothesis, it must be shown that in the 1980s and 1990s this long term trend accelerated significantly.

To empirically test this hypothesis, we inspect the behavior of the export-GDP ratio for five country groups and the world as a whole: the sub-Sahara, South Asia, East Asia, Latin America, and the OECD countries.⁶ The hypothesis is tested by regressing the share of exports in GDP (logarithmic form) against a time trend, and dummy variables for five-year periods, with the first five year period omitted. The results are presented in Table 1, with all non-significant coefficients omitted. Inspection of the last row of the table shows that for every country group, there was a significant and positive trend in the export-GDP ratio over the thirty-eight years, 1960-1997. As to be expected, the highest trend is for the East Asian countries, for which the ratio increased at seven percent per annum.⁷ However, the tests for differences across periods prompts the rejection of the ‘new era’ hypothesis. For two country groups (South Asia and the OECD) and the ‘world’, there was a significant *upward* shift in this measure of ‘openness’ only in the pre-globalization period 1975-79. For the OECD countries, this was probably the result of the increase in intra-European trade. For the ‘globalization’ periods, none of the shift-coefficients are significant, with the exception of the *negative* shift for South Asia. Thus, the share of exports in total production, for groups of countries and the world as a whole, was no different in the 1990s than what one would have expected on the basis of long term trends. Further, if in 1985 one had calculated the trends for each group over the previous twenty-five years, then projected to 1997, the predicted value would not have been significantly different from the actual value.⁸

⁶ In Tables 1, 2, 4 and 5 World Bank categories are used. See *World Development Indicators 1997*, CD-ROM. The North Africa and the Middle East group is not included because of missing data for some or all of the indicators. For political reasons, the World Bank excludes Taiwan (‘Republic of China’), which would otherwise be in the East Asia group.

⁷ This does not refer to percentage point increases, but the percentage rate of change (i.e., the elasticity of X/GDP with respect to time).

⁸ This conclusion is implicitly suggested in a World Bank publication: ‘Though developing countries in the aggregate kept pace with the world rate of trade integration, the ratio of trade to GDP actually *fell* in some 44 of 93 developing countries in the last ten years [i.e., 1985-1995]’ (World Bank 1996a, rear cover, emphasis in original).

To pursue this point further, in Table 2 the growth rate of constant-price exports is subjected to a similar statistical test. In this case, no trend is included, so the test is for differences in export growth across periods. Again, the ‘new era’ hypothesis fails to gain support. Only for the countries of the sub-Saharan region is export growth consistently and significantly higher in the ‘globalization’ periods, yet these countries, by general agreement among ‘globalizationists’, were the ones least integrated into the world economy.⁹ South Asia displays one significantly higher coefficient (for 1990-1994), and all the others are non-significant.

For direct foreign investment, the evidence is even stronger against the ‘new era’ hypothesis. When one accounts for the trend of direct foreign investment in GDP (positive for each group), for none are there significant globalization coefficients.¹⁰ Further, the level of foreign direct investment is less than two percent of GDP for each region, or considerably less than a tenth of gross domestic investment. This small proportion implies, that except for unusual cases, it is not credible to assert that foreign direct investment could be the ‘engine’ of growth or even technology transfer for most countries.

An alleged benefit of a more integrated world economy in the new era is that the increased efficiency associated with freer trade and capital flows would generate faster growth.¹¹ There is virtually no rigorous empirical work which seeks to test this hypothesis, though it is the linchpin of the justification for liberalization and new era benefits. Indeed, if the new era has not brought faster growth, it has no justification at all. The mechanism by which faster growth is allegedly achieved is through a more efficient allocation of resources, via comparative advantage with freer trade, and a more

⁹ In a World Bank report, twenty-four of thirty-six sub-Saharan countries were defined as ‘weak’ or ‘slow’ integrators for the ‘early 1980s to early 1990s’, ten a ‘moderate’ and only two as ‘fast’. No other group (East Asia, South Asia, and Latin America) had close to two-thirds of the countries in the ‘weak’ and ‘slow’ categories (World Bank 1996a, Table 2-2, p. 25). It can also be noted that for the periods when export growth was significantly *higher*, GDP growth was significantly *lower* for the sub-Saharan group.

¹⁰ The World Bank data base (*World Development Indicators 1997*, CD-ROM) does not give foreign direct investment aggregated by groups, but only by country. The statistics in Table 3 are simple averages across countries for the groups as defined by the World Bank. The data base does not report foreign direct investment for OECD countries.

¹¹ See, for example, ‘greater openness will do the most to sustain East Asia’s rapid economic growth...’ (World Bank 1994b, back book jacket).

efficient distribution of capital across countries. If there have been efficiency gains, then one would expect to find that for ‘more integrated’ countries the growth rate is higher for any rate of investment. This can be specified by use of a Harrod-Domar model:

$$g_w = \alpha\beta + \phi P_t$$

Where g_w is the ‘warranted’ rate of growth, α is the output-capital ratio, β the investment-GDP ratio, and P_t a shift variable associated with the ‘new era’. If allocative efficiency increased in the new era, then a time series regression should produce a positive coefficient for ϕ . This hypothesis was tested, and the results presented in Table 4, which seeks to answer the question, given the rate of investment for each group of countries, are there differences in growth rates among time periods? The answer is ‘yes’, but where differences appear they do not support the new era prediction. For South Asia and East Asia, there are no significant differences. For the sub-Saharan region, the growth rate for 1975-1979 is significantly lower, and also for 1980-1984. Some support might be found for the new era hypothesis from the lower growth ‘discount’ for 1985-1989, were it not the case that the discount for 1990-1994 is the highest of any period. For Latin America, the result is similar, a decline in the growth discount for both periods in the 1980s, but a return to the ‘debt crisis’ level for 1995-1997. For the OECD countries the discount is greater for both periods of the 1990s than for the 1970s, and for 1990-1994 virtually the same as for the ‘debt crisis’ period. Thus, the evidence suggests that at best, the ‘globalization’ periods showed no improvement in growth.

With regard to the investment-GDP itself (Table 5), there are no significant coefficients for the ‘globalization’ periods, except for the OECD countries, which show lower ratios for all three periods, 1985-1997, adding to the long term downward trend. In other words, in the advanced countries, ‘globalization’ was associated with a downward shift in the investment rate, even when one accounts for the negative trend. Figure 1 shows the behavior of investment over thirty-five years. The figure is constructed with an OLS regression across the five country groups and over time, with dummy variables assigned to each year (with 1961 omitted). The vertical axis measures annual percentage variations from the average investment rate across groups and years. From 1962 through 1978, over twenty-five years, there was a continuous increase in the investment rate

relatively to the thirty-five year average, except for a downturn during 1965-1968. This was followed by a virtually continuous decline from 1978 through 1984 (1981 being the only increase), after which the investment rate again began to rise, to a peak in 1990. This was followed by another down-and-up cycle in the 1990s. The figure suggests that investment rates showed increasing instability in the ‘globalization’ periods, a point pursued in a subsequent section.

Figure 2 brings together growth rates and investment ratios. As in Figure 1, annual growth variations are calculated by a regression across country groups and years with dummy variables assigned to years, using the Harrod-Domar equation (see discussion above).¹² The series with solid markers uses the actual investment rate, while the series with plain markers assumes the investment rate to be constant at the average for all years. Both series show pronounced cycles. If one excludes all single year breaks in movements,¹³ there are four complete cycles: 1964-1969, 1969-1977, 1977-1984, and 1984-1994, with durations of five, eight, seven and at least ten years.¹⁴ This sequence suggests that something different did happen in the ‘globalization’ period: beginning in 1984, world growth entered into a relative decline, with a cycle duration considerably longer than those in the 1960s and 1970s.

More important from Figure 2 is the vertical difference between the two series and their relationship to the horizontal axis. During the ‘pre-globalization’ period, 1962-1979, the estimated annual growth variations were negative for five of eighteen years (1962, 1967, 1972, 1975 and 1979), or twenty-eight percent. For the ‘globalization’ period, 1985-1995, they were negative in eight of eleven years, *even though the investment rate was above average in each year*. For a given rate of investment (unshaded markers) growth was consistently lower after 1973 than before, and lower still after 1986. Inspection of the annual growth coefficients shows that during 1962-1973,

¹² That is, it is estimated from the equation:

$$\ln[g_t] = a_0 + a_1 \{ \ln[\text{inv/gdp}]_t \} + a_{2i} [5 \text{ year period}] + \dots + a_{3j} [\text{Country group}] + \dots \varepsilon$$

The periods are 1965-69, etc., and the country groups are the sub-Saharan, South Asia, East Asia, Latin America, and the OECD.

¹³ That is, if the following years are treated as random deviations from the surrounding trend: 1967, 1973, 1980, 1988.

¹⁴ Ten years for the latter duration assumes that the 1995 downturn would continue. If not, the cycle would be longer.

growth was almost fifty percent above the thirty-five year average for the constant rate of investment, twenty-three percent *lower* during 1974-1986, and thirty-two percent *lower* during 1987-1995. In other words, *the output return to investment declined*, hardly consistent with increased allocative efficiency of either capital or for resources as a whole.

We can conclude that the ‘new era’ was not associated with significantly increased world trade, faster growth of exports, nor increased foreign investment (beyond long term trend values); however, it does appear that ‘globalization was associated with lower growth. We pursue these points analytically in the following section.

Critique of the Conventional Analysis

The discovery that growth rates have declined across countries during the ‘globalization’ period should come as no surprise, for two reasons: first, there is no compelling theoretical argument in orthodox theory that greater allocative efficiency (if such occurred) would increase growth rates; and, second, the macro Golden Rules of the new era can be shown by orthodox theory to be growth depressing, or, at best, growth-neutral.

The first point can be demonstrated by use of the neoclassical ‘production possibilities frontier, presented in Figure 3. The curve PP’ is the familiar, first-year economics locus of all maximum production points in a two product economy (full employment of resources). With no trade (‘autarky’), consumption and production are at point ‘a’, with domestic relative prices ‘ p_d ’. In a neoclassical world, this is an inefficient allocation of resources. If the country eliminated all trade barriers, it would face the relative prices of the world market, ‘ p_w ’. This would result in a reallocation of resources to the production combination ‘b’, followed by trading along the world price line, to arrive at some point like ‘c’.¹⁵ Thus, the distance along the line designated ‘free trade’,

¹⁵ For simplicity it is assumed that consumption remains in the same proportion as at point a. This highlights the increase in ‘welfare’, since more of both commodities are consumed after free trade is implemented.

from a to c, measures the inefficiency of resource allocation under ‘autarky’. Assume that this inefficiency is quite high, say five percent of national income. Assume further that in the general equilibrium at point c, the rate of saving and investment is twenty percent of national income, with a capital output ratio of four. On these assumptions, the rate of growth of the ‘efficient’ economy is five percent per annum.

For purposes of argument, let the government of the country, in defiance of all neoclassical rationality, maintain ‘autarky’. At the same time, let the government further ‘distort’ markets by introducing a forced saving scheme which raises the rate of saving to twenty-four percent of national income. The increase in saving is then used by the government to invest, or allocated to the private sector for investment.¹⁶ With the same capital-output ratio, the rate of growth rises to six percent per annum. After five years, national income is the same for the ‘efficient’ and ‘inefficient’ cases, and after ten years the later has a national income five year cent higher than the former. If the ‘inefficient’ case has a saving rate of twenty-eight percent (growth rate seven percent), national income is equalized to the ‘efficient’ case in less than three years, and after ten years is fifteen percent higher.

Thus, examples in which ‘distorted’ economies grow faster than ‘undistorted’ economies are simple to construct. The orthodoxy must demonstrate that there is some mechanism by which the apparently growth-increasing ‘distortion’ undermines itself, to produce slower growth.¹⁷ And since no country is free of distortions, it must be demonstrated that each specific distortion is growth reducing in its own specific manner, and that its growth-reducing effect overwhelms its growth-enhancing effect. In the absence of a theoretical framework to demonstrate this in general,¹⁸ the effect of distortions on growth is an empirical question.

¹⁶ The example corresponds to the policies of several East and Southeast Asian countries, which through social security schemes and other mechanisms raised saving rates (see Palma 1996).

¹⁷ An obvious neoclassical objection to our example would be that raising the saving and investment rate would have the effect of increasing the capital-output ratio. Even if this could be shown to be logically valid, whether the rise in the latter off-set the rise in the former in any particular case would be an empirical question.

¹⁸ The famous Theory of the Second Best precludes any general argument: the impact on the efficiency of an economy of removing some but not all distortions cannot be predicted.

While no conclusion can be reached on the basis of neoclassical theory about the relationship between increased allocative efficiency and growth, the growth consequences of orthodox macro policy is quite clear. As discussed above, the new era macro rules call for low deficits, high real interest rates, and low inflation. Deficit reduction, other things equal, results in a fall in aggregate demand. This fall in demand would be off-set if the deficit reduction led to a fall in real interest rates, which, in turn, increased private investment by more than the negative net fiscal stimulus (a reduction in 'crowding out'). As before, theory cannot demonstrate this; it is an empirical question, whose outcome depends on the elasticity of the interest rate with respect to the deficit, and the elasticity of investment with respect to the interest rate. However, one need not investigate these elasticities to critique orthodox macro policy, because in practice it calls for high real interest rates. If deficit reduction does not lead to lower real interest rates, then, whatever else it may or may not do, it reduces demand.¹⁹

Parallel to the 'crowding out' argument is that orthodox macro policies foster growth by reducing inflation.²⁰ To produce a theoretical sequence by which a reduction in inflation would increase growth requires considerable imagination, as well as immunity to empirical evidence. A recent study, sponsored by the World Bank, reached the conclusion that for rates of price increase of less than forty percent per annum there is 'no evidence of a consistent relationship between growth and inflation, at any frequency' (Bruno & Easterly 1995, cover page).²¹ In the absence of an inflation-growth link, the new era macro rules collapse under their own weight: if higher inflation does not reduce growth, then deficit reduction becomes a question of ideological preference rather than 'sound policy'. Similarly, tight monetary policy (with high interest rates) is revealed for what it has always been recognized to be: deflationary and contractionary.

Neoclassical theory predicts that the new era macro rules would be growth reducing; the empirical evidence confirms that prediction. Yet, these rules are presented

¹⁹ For a more detailed discussion of the Golden Rules of new era macro policy, see Standing, Sender & Weeks (1996, Chap. 2) and Mosley, Subasat & Weeks (1995).

²⁰ If something could be made true through repetition of assertion, this relationship would be incontrovertible. For a presentation of the benefits of inflation reduction refreshingly free of nuance or sophistication, see World Bank (1994a), where a regression purports to show that lower inflation leads to higher growth (refuted in Mosley, Subasat & Weeks, 1995, Table 3).

²¹ The authors found that high inflation, or 'inflation crises', have a strong negative effect on growth.

as if they were ‘best practice’, in defiance of clear theory and evidence. Twenty years ago no reputable economist would have endorsed such a patent absurdity, that demand reduction stimulates growth. The theory has not changed; rather, the political and ideological context has changed, and opportunistic arguments of convenience have become respectable. This change results from a shift in political and economic power from productive to financial capital.

An Analytical Framework

To understand the material and ideological changes that gave rise to ‘globalization’, it is necessary to consider the nature of capitalist social relations. By doing so, it will be possible to identify the essence of the changes in the world economy which are misleadingly summarized by this journalistic term. The changes arise from the contradictions of capitalist production and circulation, combined with concrete policy actions that realized the destructive potential of those contradictions. The essential contradiction that created the special character of the 1980s and 1990s is that profit arises from the production of commodities, but accrues to capital through exchange. As a result of conscious policies in the advanced countries, ‘pioneered’ in the United States and the United Kingdom, financial capital asserted itself over productive capital, such that the struggle over the distribution of profits between the elements of capital became dominant over the production of profit. In order to make this conclusion more than an assertion, it is necessary to develop in some detail the materialist (‘Marxist’) theory of value.

In capitalist society, the products of labor appear as ‘an immense accumulation of commodities’ (Marx 1974, p. 43). That commodities are the product of human labor in itself implies no particular value theory; it is a statement of the obvious. Equally obvious is that a commodity has a dual nature. For the seller it represents a quantity of value, which when realized in general-equivalent form can be used to acquire another commodity through further exchange. For the buyer a commodity represents a quality which is sought for a particular purposeful use (its use value). The distinction between the quantitative and qualitative aspect of a commodity is obvious and descriptive. It is

the pursuit of this obvious dichotomy that yields the labor theory of value, the laws of capitalist development, and an understanding of the nature of 'globalization' at the end of the twentieth century.

The exchange value and use value of a commodity are not in peace with each other. While the former can vary due to immediate and longer-term influences, the latter retains an intrinsic character; specifically, improvements in the methods of production can reduce exchange value for a given use value. On the basis of the tension caused by this real dichotomy arises the need for money, which is a general equivalent commodity of exchange. Out of the 'unpacking' of the commodity arises the need for a further concept. Since commodities do not exchange directly for each other, but through the intermediary form of money, the possibility arises that the exchange value of a commodity can vary as conditions of exchange vary. This raises the question of what determines the exchange value of a commodity; i.e., the underlying determinant of exchange value as the money a commodity fetches fluctuates due to stochastic influences.

All theories of market prices posit the existence of an underlying determinant of exchange value which is hidden beneath the price form of exchange. In neoclassical political economy the underlying determinant is the 'opportunity cost' of both producers and buyers; in materialist analysis it is socially necessary labor, a concept yet to unfold. For both schools, there is a *value* of commodities which lies beneath the surface of exchange. 'Value' has a straight-forward meaning: that which determines price, appearing in the form of quantities of money.

Like commodities, money has a contradictory nature. As the general equivalent, it circulates with commodities, but, unlike other commodities, it need not be sold to realize its exchange value. With this characteristic it can serve as a general store and claim on value. As a claim on value, it can initiate exchange for commodities, commodities which can, in turn, be sold for money again. This process, exchanging money for commodities, then commodities for money, would only be done if the second quantity of money exceeds the initial quantity. In this way money serves as *capital*, and is self-expanding value; money which through its circulation yields more money. Exchange takes two forms: commodities via money to other commodities, and money via commodities to a greater quantity of money. The former, selling in order to buy

(commodities - money - commodities, C - M - C), is the simpler. It is simple, because it requires little theoretical explanation. It involves disposing through exchange of a commodity whose use value is not desired, in order to obtain money, which can be employed to acquire a desired commodity. It is an equivalent exchange with no increase in values.²² The second, buying in order to sell, is theoretically complex. It demands an explanation of the source of the increased quantity of money, the ‘surplus value’. As it appears, surplus value is a simple concept: the quantitative difference between the money at the end and beginning of a process of buying in order to sell. The theory of value arises from the need to explain its source.

We can rule out surplus value deriving *in the aggregate* from exchange itself.²³ It follows that capital (money) must exchange initially for a commodity whose value increases, or a commodity that is value increasing, between the moments of buying and selling. A commodity’s value increases by entering into a process of production. The neoclassical school would agree that value arises in production,²⁴ though its treatment of production is essentially tautological.²⁵ Since an increase in value in the aggregate arises from production, it follows that capital passes through production to obtain surplus value. The full circuit of capital takes the form:

$$M - C \dots P \dots C' - M'$$

[Money >> Commodities, {Production}, Commodities >> Money]

The next step in the analytical unfolding is also non-controversial: the first purchase by the capitalist (M - C), must involve the acquisition of a commodity or commodities which, when used in production, add value. The elements of production

²² Marx called this process ‘simple commodity circulation’.

²³ Consider a two commodity closed economy. The rise in the exchange value of one commodity implies a decline for the other. Thus, exchange redistributes rather than creates surplus value. A neoclassical would not contest this theoretical argument, but would insist that individual and social welfare is increased by exchange.

²⁴ The neoclassical disagreement would come on two issues: 1) the process by which value is added in production (marginal productivity theory), and 2) what constitutes ‘production’ (rejecting the distinction between productive and unproductive labor).

²⁵ In neoclassical economies, market prices oscillate around long run general equilibrium prices. If short run and long run average cost curves have a unique minimum point, and no ‘above-normal’ profits are earned in any sector (perfect competition), then the general equilibrium set of relative prices is independent of demand. Demand determines the composition of output in general equilibrium, but not relative prices.

can be divided between laborers (L) and the material means of production (MP). Including these, the full circuit becomes:

$$M - C[L, MP] \dots P \dots C' - M'$$

[Money >> Elements of Production, {Production}, Commodities >> Money]

The labor theory of value lies latent in this circuit. The fundamental difference between this analysis and that of neoclassical economics is that the former has re-cast the analysis of value as the movement of capital, while the latter treats value as the outcome of the desire by human beings for consumption.²⁶ However, our analysis cannot progress beyond description without an explanation of the origin of the surplus value arising from the circulation of capital.²⁷

Even if one preferred to use the opportunity cost theory of value, the framework, $M - C \dots P \dots C' - M'$, precludes it. In the neoclassical theory of value commodities are not produced in the real world sense. Stocks of 'primary inputs' ('labor' and 'capital'), when combined with a given technology, generate a flow of new value. In this stock-flow description of the economy an opportunity cost theory of value is consistent, albeit under highly restrictive conditions.²⁸ The materialist description of aggregate reproduction is not stock-flow, but involves the production of commodities by means of commodities (to use Sraffa's term²⁹). In this description, the process of reproduction is considered through time, rather than in a timeless equilibrium period. In some arbitrarily selected initial time period (in principle one could go back to the Garden of Eden), there is produced a set of commodities which will be the input in the next time period. In the next time period those commodities are transformed into different material objects,

²⁶ It is this re-casting that eliminates the concept of 'utility' from the analysis.

²⁷ Even as pure description the foregoing is a considerable improvement upon neoclassical analysis, which treats a capitalist society as the exchange between individual agents, or even the Keynesian 'circular flow'. For a critique of the latter, see Weeks (1989, chap. 1).

²⁸ If production involves more than one output neoclassical value theory is consistent only in general equilibrium. See Weeks (1989, chap. 10) and Fine (1980, chap. 3).

²⁹ It would be more correct to write, 'production of products by means of products'. This indicates the generality of the framework; i.e., it is not limited to a system of commodity (capitalist) production. When viewed in this way, production cannot logically be treated in terms of value added categories alone, but must be analyzed in terms of the total social product (value added plus intermediate production). The Keynesian categories of consumption, investment, etc. have their analogues in materialist theory, but are not the relevant categories of analysis (see Weeks 1983, *passim*).

during which value is added to them.³⁰ This view of production formally excludes marginal productivity analysis. It does so not because it allows no substitution between inputs,³¹ but because formally there is no difference between material inputs that are consumed during one period of production and those used-up over many time periods.³² The commodity which can expand value is the laboring activity of human beings. This commodity which capitalists buy is the capacity to work, *labor power*.

It is a tautology that each commodity is the product of human labor.³³ When commodities exchange, they are rendered equal in practice. By definition, the labor that produced them is rendered equal through exchange: the concrete labor expended in production is converted to *abstract labor* in exchange (i.e., into money). This purely formal conversion of concrete labor into its opposite becomes a real conversion through the process of competition. Competition among producers of a particular commodity establishes a standard input requirement, which Marx called *socially necessary labor*. This is rendered abstract through exchange, becoming *abstract socially necessary labor*. The labor theory of value is the explanation of the process by which abstract necessary labor is established through an integrated social process of production and exchange. Competition results from the general production of commodities when labor power is also a commodity; a common norm for the production of each commodity arises from the exchange of inputs and outputs. At each stage in the input-output process capitalists encounter the discipline of exchange (Weeks 1990).³⁴

³⁰ The essence of the production process is the material transformation of objects. The addition of value is a historically specific outcome. For example, a subsistence farmer who plants maize seed does not add value in production; he/she engages in specific and concrete labor which, if successful, results in more maize than was planted as seed.

³¹ Neoclassical marginal productivity theory is consistent with fixed coefficients of production, as demonstrated decades ago in Dorfman, Samuelson and Solow (1958, chap. 3).

³² At a more concrete level of analysis, the distinction between materials of production (circulating means of production) and tools of production (fixed means of production) is crucial (see Weeks 1981, Chaps. 7 & 8). Unfolding this argument is unnecessary for current purposes.

³³ There is little controversy over whether units of labor time can be employed to *measure* value. Measurement is essentially a trivial exercise for which there are several possibilities. For example, if we consider only material commodities (excluding services), one could aggregate by weight. However useful this might be for certain purposes, such as planning the transport of commodities, it makes no sense as a theory of value. Similarly, labor time can be used as the unit of measure; the debate is over its significance for understanding aggregate reproduction.

³⁴ Marx referred to the disciplining effect of exchange when he wrote, 'a commodity is, in the first place, an object outside us' (Marx 1974, p. 43).

We can now summarize the theory of value or *law* of value: commodities are the products of human labor which are produced within the discipline of capitalist exchange, both for the output and the inputs that are used to create the output. Production is formally private, but essentially social.³⁵ Every capitalist producer participates in social interaction in which his/her commodity is but one part of an organic whole. This system of social reproduction arises from labor power being a commodity. The commodity status of labor power results from the separation of producers from the means by which production can be carried out. Workers are re-united with the means of production through the agency of capital. Having re-united workers and means of production through exchange, capitalists must transform commodities back into money.

The surplus value arises from the extraction of surplus labor in the process of production. This surplus labor is created as a result of the difference between the value of the commodity labor power and the value which labor power creates during a production period. Society's aggregate labor can be divided between that necessary to reproduce the working population, and the labor expended over and above that reproductive minimum, *necessary labor* and *surplus labor*.³⁶

³⁵ It is essentially social for two reasons. First, within units of production it involves cooperation among human beings, a social process. Second, no commodity is created within one production unit. every commodity is the result of the production of many commodities, which serve directly and indirectly as inputs to it. Thus, the essence of production is production in the aggregate, with each individual commodity a constituent part.

³⁶ This division implicitly assumes the division of society into classes, so that there is a dominant group which appropriates the surplus labor.

This discussion establishes two points that are the keystones of the analysis of ‘globalization’: profit (surplus value) arises in production; and it is distributed among the functional forms of capital through exchange. Productive (‘industrial’) capital oversees the production of profit; unproductive (financial) capital oversees its distribution among the constituent parts of capital. For its unproductive distributional services, financial capital receives a return. The tension between productive and unproductive capital gives rise to the special character of the world economy in the 1980s and 1990s.

Dominance of Finance Capital

From the simplest form of capital, $M - C - M'$, it appears that value can expand in the absence of production, requiring exchange alone. While this is impossible in the aggregate, capital seeks, when possible, to achieve the promise of profit without productive engagement. Prior to the full development of capitalist production relations (wage labor) in the advanced countries in the late eighteenth century and early nineteenth century, this was achieved through the agency of merchants’ capital. Merchants’ capital devoted itself to trade, not production, achieving profit literally through buying cheap and selling dear. In those countries where capitalist relations came to dominate production, the importance of merchants’ capital declined relatively to productive capital. Parallel to the development of productive capital emerged financial capital, which served as an intermediary for the concentration and centralization of productive capital (Weeks 1985-1986).

Between productive and financial capital there exists an inherent tension, with the former seeking to achieve profit via the appropriation of surplus value created under the domination of labour by productive capital. This tension arises from the functions of capital, rather than from a formal separation of productive enterprise from financial institutions. That is, the tension is systemic, residing within a capitalist enterprise which performs both functions, as well as between institutions separated by function. In the advanced capitalist countries between the World Wars, most notably in the United States, formal state regulations were legislated to separate financial from productive capital. As

part of this process, financial capital was highly regulated into a compartmentalized system of commercial banks, investment banks, and other specialized financial institutions.³⁷ The key aspect of this regulation was that each component part of the financial system was strictly regulated in the activities it could pursue. After the Second World War, a system of fixed exchange rates was introduced by the victorious powers, to be supervised by the International Monetary Fund. Thus, from 1945 until the mid-1970s, the scope for speculative action by financial capital was severely limited.

The dramatic expansion of lending by advanced country commercial banks to governments of underdeveloped countries was a direct result of financial regulations, especially the New Deal regulations in the United States. The accumulation of large deposits of 'petro-dollars' in the major commercial banks created the possibility of a dramatic increase in lending. However, the particular form that lending took was the result of restrictions on commercial bank operations. When deregulation of financial institutions began in the second half of the 1970s, commercial lending to governments virtually ceased.³⁸ More important in the long run, the deregulation process eliminated the legal distinction between financial and productive capital, such that the merger of the two functions in the same institutions became increasingly prevalent.³⁹ Coinciding with this, the end of the system of fixed exchange rates created an entirely new arena for the intervention of unproductive capital. Further, deregulation of the process of corporate mergers and take-overs engendered a virtually unlimited field for financial speculation.

Thus, a series of concrete and purposeful state policies created a new environment for capital, in which unproductive speculation could be pursued with limited oversight. The effect of these policy changes was to liberate capital from regulatory constraint. As a result of this liberation, the unproductive aspects of capital's circulation achieved dominance over the productive aspects. Therefore, it is not surprising that the 'new era'

³⁷ The Glass-Steagall Act during the first Franklin Roosevelt administration established the regulations limiting the activities of commercial banks in the United States (see Acks & Canavan 1989).

³⁸ Writing in 1989, Lissakers concludes,
[Debtor countries] are in financial straits in part because commercial bank funds are no longer flowing. Foreign bank credit has dried up because the underlying macroeconomic, institutional, and regulatory conditions that drove banks heavily into cross-border lending in the 1970s are no longer present. (Lissakers 1989, p. 68)

is not characterized by significantly more trade, foreign direct investment, or productive efficiency, but, rather, by currency speculation and financial take-overs. The dominance of the financial over the productive function explains the great emphasis in orthodox policies on ‘liberalization’ of financial markets in underdeveloped countries, not withstanding the obvious disfunctionality of this deregulation.

Capital Runs its Course

With the current dominance of capital as finance over capital as agency of production, capital as a social relation has ‘run its course’, in that it manifests itself in its most socially dysfunctional form. While the ideologues of capital may produce mathematically elegant models to demonstrate that deregulated capital results in equilibrium, harmony, and stable growth, quite the opposite is obvious for all to see, in Mexico and Indonesia, to take two recent examples. As a beast taken from the wild and domesticated will return to a feral state when freed from restraints, capital undergoes a similar reversion when ineffectively regulated. However, what policy has created, policy can undo.

The argument that the present deregulated financial markets result from an inexorable and irreversible process of ‘globalization’ is an ideological assertion that seeks to forestall policy changes that would limit the destructive tendencies of capital. Yet, a range of policy measures could be implemented, and have been implemented to constrain the movement of financial capital. Measures successfully used in underdeveloped countries include transaction taxes on foreign exchange dealings, restriction of foreign capital in dealing in futures markets, and reserve requirements for portfolio investments.⁴⁰ Like a river that runs wild and overflows its banks, financial

³⁹ Japan is the notable exception to the process of financial deregulation, and has come under pressure from the US government to initiate the process.

⁴⁰ For example,

Chile...continued to expand the scope of measures designed to control the pace of its net capita inflows. Reserve requirements were extended to various portfolio investments...Restrictions were placed on banks’ use of the formal foreign-exchange market...(UNCTAD 1996, pp. 37-38.

capital can, to a certain extent, be channeled and tamed. The barrier to achieving this is not the inevitability of 'globalization', nor the impossibility of implementing controls, but, rather, the difficulty in constructing a political coalition in each country that would force the necessary policy changes.

The possibility of such a coalition has been weakened by a second major characteristic of the 'globalization' era: along with the liberation of financial capital has gone a concerted and relentless attack upon trade union movements (see Weeks 1998, pp. 47-51). The rebuilding of the strength of organized labor, in advanced and underdeveloped countries, is the viable vehicle for creating the political conditions for re-regulation of capital. While organized labor's strength is weaker in the 1990s than it has been since the end of the Second World War, this weakness should not be exaggerated. In Western Europe trade union movements retain considerable political power, and potentially so in Japan. In Latin America military dictatorships in the 1970s profoundly weakened organized labor, laying the ground work for liberalization in the 1980s to be carried out by nominally democratic governments. But these movements are again active, in opposition to the excesses of 'globalization'. While in each country progressive coalitions can implement effective reforms to constrain capital, the key to a fundamental policy shift at the international level is the emergence of a progressive political movement in the United States.

The assertion that the present era of deregulation of finance capital is inevitable gains superficial credibility by the view of 'progress' arising from the eighteenth century Age of Reason, from which neoliberal ideology derives its origin. In this philosophy, history's development is essentially linear, and each period is the culmination of the changes that preceded it.⁴¹ Thus, current policies are not alternatives which have been consciously chosen over others, but, rather, the synthesis and most advanced expression of what have gone before. Previous policies that constrained capital are seen as anachronistic, irrelevant to the new, more advanced stage of society. To the extent that materialist philosophy has also fostered such a linear view of history, it must be amended to treat history as a cyclical process, in which policies reflect the balance of class power.

⁴¹ I wish to thank Elizabeth Dore for pointing out this ideological treatment of history.

At the end of the nineteenth century, in the context of an apparently triumphant imperialism and domination of capital over labor, the ideologues of capital proclaimed the dawn of a new era in which that triumph and domination would be eternal. Similarly, the current domination of finance capital is proclaimed as the inexorable outcome of irreversible market forces. However, the current policy framework is no more eternal than that of the late nineteenth century, which came to an abrupt end through a devastating European war and the Russian revolution. While one cannot predict the vehicle by which the dominance of finance capital will end, one can recognize it as but a moment in the life cycle of capital, which can be altered through conscious political intervention.

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Tables and Charts

Table 1:
Exports as a Proportion of GDP and Long-term Trend,
by Period Compared to 1970-1974
(OLS method)

<u>Groups</u> Periods	<u>Sub-Sahara</u>	<u>South Asia</u>	<u>East Asia</u>	<u>Latin America</u>	<u>OECD members</u>	<u>World</u>
'Pre-Glob'tion' 1965-69	no consistent data	no consistent data	no consistent data	no consistent data	no consistent data	no consistent data
1970-74	for the 1960s	for the 1960s	for the 1960s	for the 1960s	for the 1960s	for the 1960s
1975-79	nsgn	+1.1	nsgn	nsgn	+1.2	+1.1
'Debt Crisis' 1980-84	nsgn	nsgn	nsgn	nsgn	nsgn	nsgn
'Globalization' 1985-89	nsgn	-1.3	nsgn	nsgn	nsgn	nsgn
1990-94	nsgn	nsgn	nsgn	nsgn	nsgn	nsgn
1995-97	nsgn	nsgn	nsgn	nsgn	nsgn	nsgn
Trend	+0.8	+3.0	+6.0	+1.3	+0.7	+1.2

Note: Only coefficients with a probability of .10 or less are considered significant. The period shift coefficients and the trend have been converted from logarithms to percentages. The source of this and subsequent tables is World Bank, *World Bank Stars 1996* (1960-1969), and World Bank, *World Development Indicators 1997* (1970-1996), both on CD-ROM; and United Nations, (1997).

Table 2:
Rate of Growth of Exports, Compared to 1970-74
(OLS method)

<u>Groups</u> Periods	<u>Sub-Sahara</u>	<u>South Asia</u>	<u>East Asia</u>	<u>Latin America</u>	<u>OECD members</u>	<u>World</u>
'Pre-Glob'tion' 1965-69	no consistent data	no consistent data	no consistent data	no consistent data	no consistent data	no consistent data
1970-74	for the 1960s	for the 1960s	for the 1960s	for the 1960s	for the 1960s	for the 1960s
1975-79	+2.3	nsgn	nsgn	nsgn	nsgn	nsgn
'Debt Crisis' 1980-84	nsgn	nsgn	nsgn	nsgn	-1.9	-1.8
'Globalization' 1985-89	+2.2	nsgn	nsgn	nsgn	nsgn	nsgn
1990-94	+3.6	+7.3	nsgn	nsgn	nsgn	nsgn
1995-97	+4.8	nsgn	nsgn	nsgn	nsgn	nsgn

Note: Only coefficients with a probability of .10 or less are considered significant. The period shift coefficients have been converted from logarithms to percentages.

Table 3:
Foreign Direct Investment as a Proportion of GDP and Long-term Trend,
by Period, Compared to 1970-1974
(OLS method)

<u>Groups</u>					
<u>Periods</u>	<u>Sub-Sahara</u>	<u>South Asia</u>	<u>East Asia</u>	<u>Latin America</u>	<u>China</u>
'Pre-Glob'tion'	no consis-	no consis-	no consis-	no consis-	no consis-
1965-69	tent data	tent data	tent data	tent data	tent data
1970-74	for the	for the	for the	for the	for the
	1960s	1960s	1960s	1960s	1960s
1975-79	nsgn	nsgn	nsgn	nsgn	no data
'Debt Crisis'					(base
1980-84	nsgn	nsgn	nsgn	nsgn	period)
'Globalization'					
1985-89	nsgn	nsgn	nsgn	nsgn	nsgn
1990-94	nsgn	nsgn	nsgn	nsgn	nsgn
1995-97	nsgn	nsgn	nsgn	nsgn	nsgn
Trend	+0.2	+0.2	+0.6	+0.2	+0.8

Table 4:
Growth Rates by Period Compared to 1960-1964
(holding investment in GDP constant, OLS method)

<u>Groups</u>						
<u>Periods</u>	<u>Sub-Sahara</u>	<u>South Asia</u>	<u>East Asia</u>	<u>Latin America</u>	<u>OECD members</u>	<u>World</u>
'Pre-Glob'tion'						
1965-69	nsgn	nsgn	nsgn	nsgn	nsgn	nsgn
1970-74	nsgn	nsgn	nsgn	nsgn	-2.5	nsgn
1975-79	-4.2	nsgn	nsgn	nsgn	-2.9	nsgn
'Debt Crisis'						
1980-84	-4.8	nsgn	nsgn	-4.0	-3.4	-3.1
'Globalization'						
1985-89	-2.4	nsgn	nsgn	-2.5	-2.1	-1.7
1990-94	-5.2	nsgn	nsgn	-1.9	-3.5	-4.0
1995-97	nsgn	nsgn	nsgn	-3.9	-3.0	no data

Note: Only coefficients with a probability of .10 or less are considered significant. The period shift coefficients have been converted from logarithms to percentages.

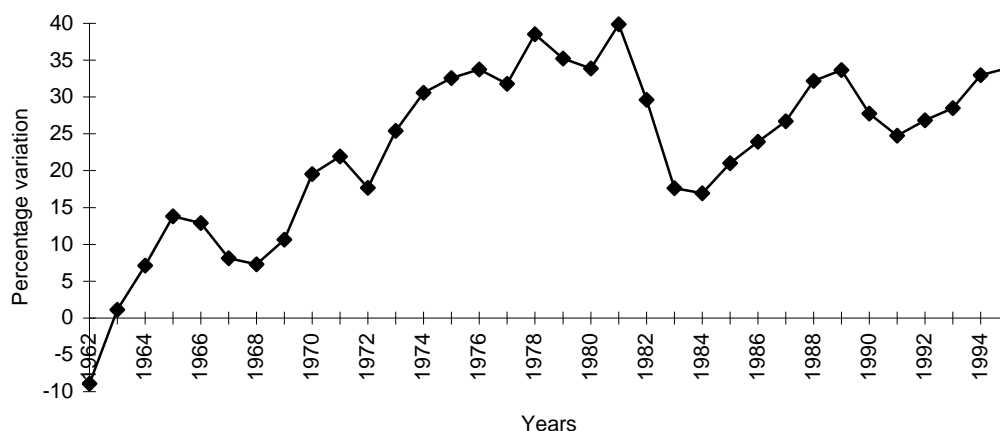
Table 5:
Gross Investment as a Proportion of GDP and Long-term Trend,
by Period Compared to 1960-1964
(OLS method)

Groups	Sub-Sahara	South Asia	East Asia	Latin America	OECD members	World
Periods						
'Pre-Glob'tion'						
1965-69	+1.2	nsgn	+1.2	nsgn	nsgn	nsgn
1970-74	+1.5	nsgn	+1.4	nsgn	nsgn	nsgn
1975-79	+1.6	nsgn	+1.5	+1.3	nsgn	nsgn
'Debt Crisis'						
1980-84	nsgn	nsgn	nsgn	nsgn	-1.2	nsgn
'Globalization'						
1985-89	nsgn	nsgn	nsgn	nsgn	-1.3	nsgn
1990-94	nsgn	nsgn	nsgn	nsgn	-1.4	nsgn
1995-97	nsgn	nsgn	nsgn	nsgn	-1.5	nsgn
Trend	nsgn	+1.4	+2.6	nsgn	-1.8	nsgn

Note: Only coefficients with a probability of .10 or less are considered significant. The period shift coefficients and the trend have been converted from logarithms to percentages.

Figure 1:

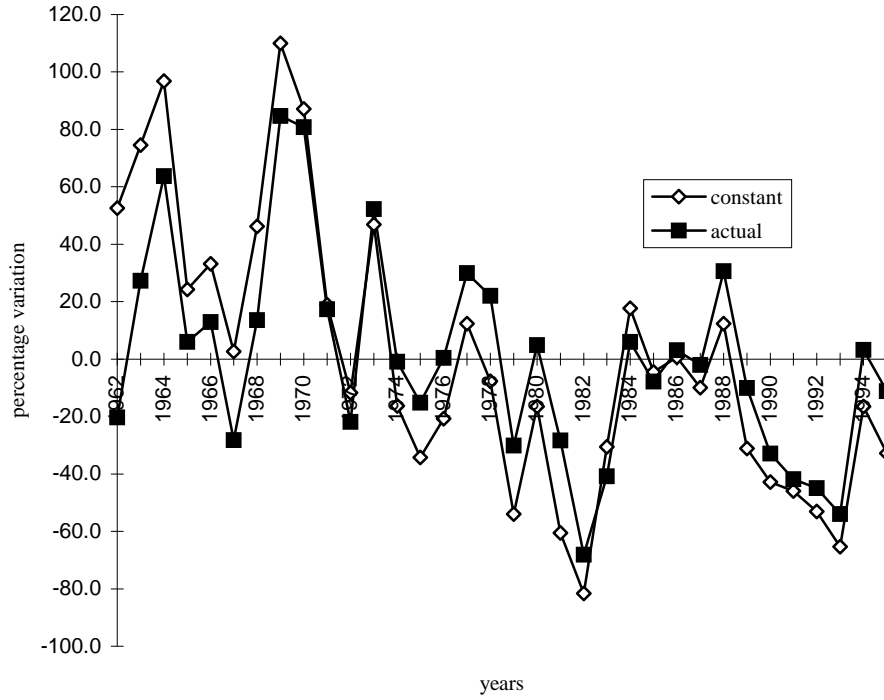
OLS Annual Variations of the Investment to GDP Ratio,
across Country Groups, 1961-1995
(from 1961 level)



Note: The following years are not significant at .10 or less: 1962-69, and 1984.

Figure 2:

OLS Annual Variations in Growth,
Actual and Constant Investment, 1961-1995



Note: The following years are not significant at .10 or less: 1962, 1967, 1972, 1975, 1979, 1981-82, & 1989-92;

