

Financial Markets Under Capitalism*

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One of the most important arguments advanced by John Maynard Keynes, the renowned economist, was that the operation of financial markets under capitalism is deeply flawed. Such markets are intrinsically incapable of distinguishing between “enterprise” where an asset is held because of the stream of returns that its ownership yields over time, and “speculation” where an asset is held not for this yield but only because it can be sold at a higher price tomorrow to someone else who in turn would buy it because he believes that he can sell it at an even higher price the day after tomorrow.

The existence of speculators in the asset markets prevents the price of an asset from reflecting its “true value”, i.e., the present value of the stream of discounted earnings from it that would accrue in future. And because of this divergence, the financial markets that channelise investible resources, i.e., the excess of society’s maximal producible (“full employment”) output over consumption that would occur when this output is produced, towards producing more of particular assets (which we call investment), are forever getting their calculations wrong. Quite apart from the distribution of investible resources between different assets, the total that is distributed is often too low compared to the available investible resources, and occasionally too high. When the latter happens there is inflation; when the former happens which is the more common occurrence there is unemployment (or what Marx had called an “over-production” crisis).

The “realisation” and distribution of investible resources, therefore, Keynes argued, could not be left to the financial markets, for then the system would be saddled for long with unemployment levels that were “unacceptable” to the people, endangering the survival of the system itself (which he himself was keen to ensure); it had to be taken over by the State. He called this takeover by the State the “socialisation of investment”. Capitalism, in short, for its own survival, required the socialisation of investment which meant the pursuit by the State of policies that would always keep the system close to full employment.

This did not mean that the State should step in only when there was unemployment. It did not entail eschewing State intervention in periods of speculative euphoria when the system would be at high levels of employment anyway, and restricting intervention only to periods when such euphoria collapses; it meant rather that the State must have a more permanent or durable role in ensuring full employment by eliminating the effects of such mood swings on employment which meant that the State must control the financial markets.

The most obvious way of controlling the financial markets was by putting restraints on the behaviour of participants in financial markets, by controlling for instance the behaviour of financial institutions, i.e., whether they can speculate or not, or whether they can channelise funds to speculators or not. Accordingly, in the United States during Franklin D Roosevelt’s New Deal, the Glass-Steagall Act was passed which distinguished between commercial banking and investment banking and prevented commercial banks that accepted deposits from the public from engaging in

speculative activity. This legislation was withdrawn during the Clinton administration which made possible the big asset-price bubbles that sustained booms in the US and hence in the world economy; by the same token, however, the collapse of the housing “bubble” has pushed the US and the world economy into much higher levels of unemployment, even before the pandemic intervened.

But it is not just the collapse of the real economy that constitutes a problem associated with the end of such speculation-induced booms; it is also above all the collapse of the financial economy. The Obama administration had to pledge \$13 trillion to prevent such a collapse after the end of the housing bubble. In fact, one of the flaws of the financial markets under capitalism is not just that employment gets determined by the whims of a bunch of speculators, but the very viability of financial institutions depends on such whims. Preventing core financial institutions from engaging in speculative activity, through direct State intervention, therefore, becomes all the more necessary.

The best way to ensure such insulation from speculative activity is through State ownership of these financial institutions. In fact, after the collapse of the housing bubble when governments all over the advanced capitalist world were using public money to rescue financial institutions that had got into crisis because of engaging directly or indirectly in rampant speculation, there was a strong public demand that these institutions should not be handed back to their old managements; they must be taken into State ownership. And in the US a good deal of the bail-out assistance given by the government to financial institutions was used by the executives of these institutions to give themselves generous salaries, bonus payments and benefits. State ownership ensures that the operation of financial institutions is not just for obtaining maximum profits, which no matter how strong the legal barriers, will inevitably expose these institutions to some speculative activity, but for a prudent and secure deployment of their financial resources. It is not accidental that a country like India with mainly State-owned banks hardly had any “toxic” assets in its banks’ portfolios when the housing bubble burst; and whatever “toxic” assets it had was concentrated only in private sector banks like the ICICI bank.

Capitalists of course would be opposed to State ownership of banks, even though it helps in preventing capitalism itself from ever experiencing a collapse of its real and financial economies. But that is because capitalism is an unplanned system where the capitalists themselves are keen on seeking higher profits and are both unaware of and unconcerned with what would stabilise the system; if capitalism wasn’t such an unplanned system, then it would not be a historically transitory one. And even a government sympathetic to the system cannot overcome their resistance to any State ownership.

But imagine the utter mindlessness of a government that is actually planning to hand over a largely State-owned banking system to private capitalists, a step that would expose the financial system to the threat of collapse; such alas is the Indian government. The stability of our financial system rests upon State-ownership of the bulk of the banks; depositors in these banks remain secure in the knowledge that they would never fail because they are State-owned, and the question of a run on these banks therefore simply does not arise. This is a contrast from the colonial times and even the pre-nationalisation period in independent India when the threat of bank failure was so pervasive that people preferred to hold their wealth in the form of

currency notes hidden under beds, or gold ornaments, or land. It is only because of nationalisation that there has finally been a change in their asset preference in favour of bank deposits that has facilitated the channelling of investible resources towards investment, through direct or indirect intermediation.

The Indian government wishes to push the clock back to those times, and there is no use pretending that the financial system now is different from the colonial times; all profit-seeking financial systems that are not legally forced to distinguish between speculation and enterprise are equally vulnerable. And even such legal force is scarcely enough.

Of course, bank nationalisation in India had a different and more immediately pressing objective, which was to channelise institutional credit to sectors that had been neglected till then but whose growth was vital for the economy, such as peasant agriculture. These sectors were charged lower interest rates, and there were “priority sector norms” to ensure that they got a certain share of the credit. Though institutional credit was unequally distributed among the different peasant classes, nonetheless the Green Revolution would not have been possible without bank nationalisation; and no matter how critical one may be of the environmental impact of the Green Revolution, there is no gainsaying that it freed the country from the “food imperialism” of the metropolis. Neo-liberalism has been persuading the government to go back on nationalisation and privatise the banking system, but till now this had been resisted; now at last there is a government in the country whose understanding of economic matters is so paltry that it can be persuaded to fall in line.

The point however is this: State ownership of banks is conducive not just for a wider reach of institutional credit, but for the stability of the financial system of capitalism itself.

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