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Fictitious Capital and the Elusive Quest in Understanding its Implications: Illusions and Paradoxes*

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Abstract

This paper deals with the interaction between fictitious capital and the neoliberal model of growth and distribution, inspired by the classical economic tradition. Our renewed interest in this literature has a close connection with the recent international crisis in the capitalist economy. However, this discussion takes as its point of departure the fact that standard economic theory teaches that financial capital, in this world of increasing globalization, leads to new investment opportunities which improve levels of growth, employment, income distribution, and equilibrium. Accordingly, it is said that such financial resources expand the welfare of people and countries worldwide. Here we examine some illusions and paradoxes of such a paradigm. We show some theoretical and empirical consequences of this vision, which are quite different and have harmful constraints.

1. Introduction

There is an extensive controversy concerning traditional models of economic equilibrium and new development paradigms based on an interdisciplinary, broader study of economics. When faced with the harmful effects of misguided directives in an economic and global sense, theorists have the obligation not only to explain their causes, but also to offer a practical solution or alternate thinking. After all, consistent levels of poverty, unemployment and low growth are results which were not expected in orthodox economic models of equilibrium and should be dealt with instead of being thrown aside as a politically restricted issue. Moreover, typical third world problems such as unemployment, recession, debt and social turbulence sided with corruption are now appearing in developed countries. There is an ethical dimension in social sciences which must not be forgotten, when presenting new views on solving crises.

It is in this sense that Jacobs points out an arrangement of guidelines destined to comprehend new economic theory.[1] Amongst an extensive list, he points out that all economic theory must be goal-oriented. This means that social sciences should have a practical use,

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that of improving human welfare. They must abandon hope of achieving a fully complete and dynamic model able to explain and control all variances of the environment. Elegance and Originality may shine through abstract theory; but it is necessary, moreover imperative, that such a theory have its adequate means in adapting itself to the reality of material means of existence.

In this paper we focus on the capitalist world after the surge of globalization, following the global 2008 crisis. For us, it is essential that the analysis of such an occurrence be linked with other disciplines, particularly the Social Sciences. After all, Economics places itself in a faulty position when it fails to emphasize human welfare as the ultimate purpose. It is in this vein that Jacobs also emphasizes that new theory "must integrate with all other fields of social life (...) and replace the concept of externalities with a growing awareness of the complex nexus of political, legal, commercial, organizational, technological, social, cultural and psychological factors that determine economic performance and results."

In order to make an interdisciplinary study on the reasons why crises occur (and what can be done), it is important to get to the roots of conventional economic theory and then to point out its differences in empirical reality.

According to neoclassical economics, a commodity's economic value is determined by the amount of labour time spent in its production process. In the classical world, labour-value and competitive market prices rearrange each other in a state of equilibrium in which money plays an intermediate role of neutral effect. Its only effect or defect would be, as a last resort, a perverse influence on price rearrangement through inflation.

Such a theory receives merit for its elegance and simplicity. However, reductionism and critical omissions may be spotted on labour-value theory, which could compromise the entire structure of the model if taken under consideration. In fact, the chosen exchange background is as simple as a barter economy. And if we can find a variety of economies based on barter, medievalism, mercantilism or slavery, the capitalist mode of production makes the approach more complex. Even though in archaic societies, cattle creation sufficed for nourishment, today our complex relations demand the rise of industry, slaughterhouses and distribution channels for socialization of consumption. In the same manner, the specialization of technology demands less hours of labour-time and more of capital use.

Thus on adding a historical component, capitalism offers an essential controversy to the model: the role of Money not as a passive extra, but as the main actor in a system where the quest for Money (and not exchange) reigns. The idiosyncrasy of such affirmation signals the importance of Money and its expanding network on the rearrangements of power structures involved in the capitalist mode of production. In this vein, Weber, Bloch and Braudel have commented notably on the role of Money throughout historical development.[2,3,4] But it was Marx who was the main analyst on the importance of Money, and the harmful effects that could occur should Money be detached from the productive dimension of an economy.[5]

Marx in *Capital* has arrived at a specific conclusion: in capitalism, circulation of Money and production of goods are relatively independent of one another, where Money is the central axis which reflects the social labour division. It does so not only because average income is determined by social needs, but also because generated income plays a greater part in determining the consumption of produced goods. However, this monetization that allows for the exchange and circulation of commodities at a generalized level is subject to a number of disturbances. These are given by credit, by the creation of money without anchorage on production, and by the "magic formulas" in which invested money may render income, without the intermediate process of merchandise and production necessary for the division of socialized labour.

Since the exchange of commodities is always underlined within the statute of production prices, one manner in which crises could occur would be through Fictitious Capital. Hence, heterodox economic theory of value does not assert its position based on a reductionist model, but as the main generalization of private and social processes at an accurate moment in history (capitalism).

This paper is organized as follows: after this introduction, Section 2 presents an overview of the theory which deals with fictitious capital, its definitions and the quest in understanding its foundations. Section 3 is concerned with implications of fictitious capital, crises, illusions and paradoxes of the liberal approach to economic policy. Section 4 concludes with some aspects of orthodox economics' adventures and misadventures in global development.

2. Fictitious Capital

A clearly observable role of Money is its possibility to separate in time operations of purchase and sale. With the rise of capitalism, money can also be seen as capable of generating surplus value and thus becomes a commodity desirable in itself. In the process of credit overture, lent money has the ability to synchronize the production capability of distinct time periods – present and future. Thus, through a credit document a firm may gain instantly an expectation of future income. It should be noted, however, that such lent credit ratifies only the supposition that a firm could generate such competence through a forthcoming capital accumulation not yet realized within the circulation process.

It should also be considered that such credit carries out periodically a charge of interest. Marx pondered on the idea that interests are not derived from supply and demand forces between lenders and borrowers of credit, but are in fact anticipations from a share of hypothetical surplus value which the capitalist would obtain if he were inclined to follow its enterprise solely on his capital accumulation. This separation between time periods conferred by credit may generate two results: i) the well-succeeded flow of capital throughout its different phases, or ii) crisis.

An especial type of capital that may produce crises is Fictitious Capital. In this vein, heterodox thinkers present alternative views or meanings.[6,7,8,9]

On the one hand, it is possible to see fictitious capital as resources that (in the same manner as credit) possess a double value, an imaginary component without anchorage on production, but may have value after a productive investment. In such matters, one can consider government bonds as fictitious capital, since they render interest based on debt. Suffice it to say that it makes its owner richer starting from indebtedness.

On the other hand, amongst Mollo's thesis and others, fictitious capital can be seen as a secondary and artificial valorisation of applied capital, without anchorage on production. In this matter, the primary issue of a stock is without doubt linked to the corresponding firm's use-value; significant changes in the use-value (excessive capital accumulation or loss of it) also influence the stock price. Nonetheless, financial market is much more than the primary issuance of a stock. Usually, assets are securitized, issued amongst investment portfolios with derivative credit. Hence their generated income surpasses far beyond a company's use-value, and is instead determined by speculative supply and demand of a number of assets.

This alteration on an enterprise's production process and its assets' profitability arises because the spring of credit allows the creation of endogenous money without correspondence to production. At first, the portrayer of such assets will always become wealthier with new profit, but in the scheme of circulation of commodities there was no productive creation enough to support such creation of wealth. As fictitious capital also presents a higher and faster profitability compared to the production process, the exceeding profits of the latter also tend to be reinvested on the former. The dissociation between prices and value intensifies, whereas the real market of production relatively impoverishes at a steep pace.[10]

The creation of credit has allowed banks to create money endogenously without an anchorage of production and has opened the room to the possibility of crises. Gradually, fictitious capital started to gain immense powers – it has the tendency to create, like a spell, money that becomes more money, richness which prompts more richness in an uncontrolled spiral. In the capitalist system where the quest for easy and fast profit is imperative for survival, it is not surprising that a great amount of money can be reallocated and invested in the financial market leading to an artificial creation of capital through interests. This severely damages the accumulation of capital and the circulation of commodities, whether by great capital outflow, or by the direct and indirect effects that the speculative market has on production. Notwithstanding, in the medium term, the attractiveness of fictitious capital binds a group of powerful followers which will advocate free capital flow. This support is given not only by governmental institutions with high economic expertise and low engagement with history, but also by theoretical economists themselves, who present a sufficient argument for wealth provided by fictitious capital and thereby the maintenance of orthodox economic theory.

In this vein, liberal mentality brought by standard economics is strengthened, the same mentality that always cared for global economic balance between all nations' exchange rates and balance of payments, paying hardly any consideration to the issue of domestic poverty and income concentration.[11] However, the so-called balance reached during the Pax Britannica hegemony was deformed to the free flow of fictitious capital within the globe, as remarked by Chesnais and Teixeira & Ferreira.[12,13]

3. Fictitious Capital and Crises

Credit is a kind of capital with double-value which links production and circulation of commodities through the anticipation of surplus-value in a manner that its entire amount is invested (though through compression of time) in production. Fictitious Capital is (in our reasoning and also of Foley and Mollo) the artificial and secondary valuation of such credit, subordinate to speculation schemes without anchorage of production and whose main interest resides on the asset itself, not the object portrayed by the asset.

If one were interested in portraying an accurate historical development of credit, it would become clear that such development is heavily linked with political thinking throughout the last few decades. Subsequent to the Second World War, economic models of minimum intervention from the state were questioned, as a reaction to their poor effects: the rise of monopolies, the deprivation of basic and beneficial conditions of life (such as health and education), the shrinkage of small businesses, and so on. This led to the *Welfare State*, a political and socio-economic model aiming at warranting human dignity through state intervention at all costs where assistance was needed.

However, in the 70s orthodox economics began to have its voice strengthened by the election of several conservative political leaders such as Thatcher, Reagan/Bush and Chirac. Such events were linked with the rise in prices brought by the rise of oil prices, amongst other crises in the decade. The result was that the Welfare State was gradually altered and capital gained more power through flexibilisation and globalization. The development of the Washington Consensus was a key event that occurred after that time and continued during the 90s. It aimed for a world with free global capital flows, and emergence of the euro-dollar market, which made it more difficult to trace money back to its origin and to establish full, effective regulation.

As a result, during the last few decades, capital has multiplied sharply. It is estimated that in 2007, generated income in the U.S. financial markets was ten times bigger that the country's GDP. Balance Payments Deficits and private indebtedness have also escalated rapidly in the United States since the beginning of this century.[14] Whereas on the financial side, wealth was uphill: big companies could splurge in swaps, debt securitization, leverage, and derivative credit to prosper without constraints. Hegemonic nations also have worked consistently to provide free capital flow and also to evade themselves from any responsibility.

For a better regard of such massive fictitious capital flow, Teixeira & Ferreira signal that in 2007 the five largest investment banks in the U.S. possessed leveraged loans up to US $4.1 trillion, which amounted to 30% of the U.S. GDP.[15] Around the same period, the appreciation of house value rose 124% from 1997 to 2006 whereas assets derived from said mortgages (such as synthetic collaterized debt obligations and naked CDS) have had their face value estimated at US $35 trillion, that is to say, 14 times the value of the same mortgages which supposedly backed them.[16] By 2009 the global financial market already possessed a face value of US $614,674 trillion, which is the equivalent of the global production of the previous 10 years.[17] Duyn's estimates are similar to Mollo's findings, in which financeirization represented, in face value, almost 10.8 times the global GDP.[18] In Teixeira and Ferreira's work, since some hedge funds promised a 30% annual interest, investing in short run speculative bonds became widespread instead of investing in the productive sector.

However, the free assimilation of Fictitious Capital increases the amount of presumed wealth in the globe, without further possibility of realization in the commodities' circulation field. This internal contradiction can only resolve itself through periodic crises, in which capital needs to destroy itself in order to realize its ultimate devaluation.

"Crises are the only symptom through which capitalism can be reborn and still sustain itself with all its inner contradictions."

The triggering of the crisis is correlated with a rise in interest rates, which conveys a difficulty in accessing credit but renders bigger profits for fictitious capital. When the interest rate rises, the payment of loans previously made are compromised and firms need to sell more assets in order to reimburse money for such loans. As many of the firms usually suffer the same conditions, the vast selling of assets knocks down prices and worsens the situation of the firms which need to sell themselves. This triggers the crisis.

In this vein, it is possible to consider that crises are not caused by exogenous and random shocks due to state carelessness, nor do markets spontaneously reach a state of equilibrium. On the contrary, the relative autonomy between prices and value and between production and circulation – entitled by money and credit – is an intrinsic conflict innate in capitalism and it must solve itself periodically through the occurrence of crises. Crisis, depression and recession are elements as common as money and speculative resource allocation in capitalism. Unfortunately, it results that the fictitious capital scheme works in favour of privatization of gains and socialization of losses. There was not, according to FeD's reasoning, a mere bureaucratic deregulation which ended up in unexpected crisis. Crises are the only symptom through which capitalism can be reborn and still sustain itself with all its inner contradictions.

4. The Orthodox Theory, its Harmful Effects on Growth and Concluding Remarks

Neoliberal theory is strongly based on models of equilibrium proposed by the founding fathers of Economics. Such framework also demands, for its consolidation, the free flow of capital. Believing that capital flexibilisation will converge global economy to a state of equilibrium is the same as assuming that a casual and grotesque fact may imprint on reality the idealized forms of a theory, and that in economics the platonic epistemology applies.

The pseudo-neutrality of equilibrium models (in all its makings) is consubstantiated by formalization born in mathematics. This approach has its origin in positivist reductionism with a normative appeal, for it does not take under consideration the real dilemmas of material means of existence. Amongst them we can cite class conflict, structures of power, and *ad hoc* political choice perpetrated in a global development and poverty reduction context.

A brief historical and political research shows first-hand that greater flexibilisation of capital does not result in a harmonic price rearrangement, but, rather, in a rash and uncontrollable crusade in which capital hunts, at every concealed hideout of the globe and the markets, which are new ways to improve exponentially its profitability.[19,20] And on this quest, the first things to run over are the jobs, the ideals of social welfare and the environment. From time to time, workers themselves are blamed for poverty, whence they are found guilty for the harm they inflict upon themselves.[21]

"Crisis is not the disease: it is the main solution through which capitalism can sustain itself in time, even when carrying within itself the "seeds of its own destruction"."

In regard to the analyses on crises, conventional thinking still puts the blame on a cause-effect relation external to the logical and formal equilibrium model. Accordingly, it would be sufficient to eliminate the exterior cause (financial deregulation) as a way of healing and preventing any other crises. This assertion is precisely what our study of fictitious capital aims to criticize. Crises do not occur through an exterior cause, they are embodied within the internal contradictions of capitalism itself. Capitalism is a living historical organism anchored in time and the bearer of a number of symptoms and internal conflicts which can only be resolved through crises. Therefore, crisis is not the disease: it is the main solution through which capitalism can sustain itself in time, even when carrying within itself the "seeds of its own destruction". This pattern of thinking is parallel to how Freud and Lacan addressed their patients: if a psychotic patient is in a delirium, delirium itself is not considered the disease.[22,23] It is a crutch the patient – a crystallized and broken subject – uses to address the disease's existence. In the same manner, the study of capitalism should not begin from a supposed state of "normality" and "convergent equilibrium" but, rather, as an analysis of a broken subject, an unstable mechanism, uneven, with strong tendencies to capital concentration. In this vein, the subject lends itself to be understood as "delirium", an unexpected state of affairs which also aims to provide the meaning of its existence. If Freud and Lacan listened to their patients' delirium, so should we listen to the symptoms of the crisis instead of ignoring them and strengthening our weak faith in normality.

Conventional and normative discourse has been used to bury underneath the ground all historical importance of resource reallocation. Nowadays, history has thrown light on the irrationality of our laws in social life, the victory of cheap labour market over humanitarianism, of profit over reduction of misery. Thus, financial capital still expands throughout the globe under the mantle of a "scientifically neutral" orthodox theory. The domain of critical multidisciplinary vision has become restricted, whereas the scope for theoretical realization is much larger. Economic intellect has become much more demanding in the formal realm and much more modest in the realm of social reality. Economic criticism is no more a combative weapon to attack world injustice, but has become a receded trench behind big companies, bankers and lobbyists. Political economy is no longer an instrument of conquest but one of renouncement.

Thereby, even under the occurrence of crises the orthodox speech solidifies itself. And specifically, the idea that capital may grant long term artificially created wealth without further damage to production, since in the long term all supply and demand would cancel themselves in harmony. It is through this reasoning which acquiesces to fictitious capital that we bring Gramsci's theory: his main idea was that the ruling class did not dominate by force, but by persuasion.[24] Persuasion was indirect: subordinate classes learned to view society through their ruler's eyes, due to an obscure schooling of reality and the foul setting of education in societal organization.

> *"Fictitious capital has become a nationless being, unruly, insatiable, thriving for infinite expansion with the promise of extraordinary profit."*

Due to "pure idealism", an abstract and ideal world is created, reminiscent of a sphere of values autonomous to civilization. This beautiful speech serves well for monopolists and bankers to maintain their power. Science of equilibrium, in this manner, is based on pseudo-neutrality, as a consequence of which science can be utilized either for humanity or for the means of the powerful. We are not nullifying or underappreciating formal science, but are, rather, in the quest of freeing it from its masters that science itself has established.

The alternative line of thought alien to conventional economics, illustrated by Marx, Keynes, Luxemburg, Kalecki and others, helps economic debate regrow after the failure in predicting the great economic disturbance that sprang in 2008.[25,26] This line of thought is crucial in revealing intellectual flaws in the model that has allowed the creation of recent crisis. The heterodox view is also important in narrating internal contradictions of the capitalist economy, suggesting a political agenda that may, under certain limits, contour serious problems in growth, distribution and instability within the economic system.

Without this critical view, it is not possible to establish a comprehensive theoretical overview of new paradigms in economic development. These should ally themselves not to capital flexibilisation and conventional economic narrative but, rather, to a multi-faceted study involving sustainable development. The former does not ignore all true questions about full employment, reduction of income inequality, sustainability of the world ecosystem, of economic social welfare and of true governance that support laws far beyond equality of rights, but has social precedents such as access to quality education and health.

The recent global financial and economic crisis has underscored the fact that despite significant increases in income and other "development" indicators in many parts of the world, in the last 50 years or so, the appropriate paths to development require serious rethinking. The rapid growth of the financial sector in the global economy has made economies fragile. Increases in inequality seem to make societies more unjust and unstable.

In short, Fictitious Capital is a specific kind of "asset" that is grown in the speculative financial market (amongst other origins) and promises to generate extraordinary profit, money that multiplies itself into more money, without any anchorage of production. As such, fictitious capital does not take part *a priori* in the "real world productive process" nor the circulation and realization of commodities; it enriches the pockets of the owners of such assets but does not constitute value which binds and holds together the axis of social relations. It is also able to align itself to the government, bankers and to powerful businessmen to find a variety of paths to expand around the globe. When its size is significant, the law of value strikes back and capital devalues itself, carrying along firms in bankruptcy, unemployment, recession and so on. And surprisingly, the answer orthodox economics offers is more capital freedom – and its dubious ability to bring back equilibrium.

In spite of the emergence of excessive deregulation, a number of financial innovations, the euro-dollar market and globalization, fictitious capital has nevertheless spread throughout the globe and has become a nationless being, unruly, insatiable, and thriving for infinite expansion with the promise of extraordinary profit. This is thus aligned with free capital mobility, and the relative immobility of workers and natural resources, many times located in poor nations with low political strength and vulnerable to market exploitation. The result is great stress not only on workers' quality of life, but also on great vulnerability to which the environment is exposed.

The recent book by Thomas Piketty signals that inequality is rising, where the author also comments extensively on the harmful effects of capitalism.[27] Taking all this information into consideration, we may suggest some guidelines to formulate new development paradigms, such as a new outlook on taxation, a higher stimulus to productive investment, granting more importance to heterodox thinking, and controlling both the rise of the degree of monopoly and of the financial speculative market.

In times of crises, heterodox thinking is most important for avoiding the traps and pitfalls that a normative equilibrium-based theory can offer. Conventional economic thinking, hopeful for a long lost, harmonic restoration point, may trigger an even worse deepening of the crisis, and may launch environmental and labour agenda into oblivion. As for the constant modelization of capital dynamics without further regard to social and historical reality, we can only say that the margins of reality, once fixated through language, cancel each other. Through the same spirit of contradiction which fictitious capital theory offers, we bring another tale narrated by Italian-naturalized writer Italo Calvino.[28] In his book, the *Invisible Cities*, it is said that the tartar emperor Kublai Khan asked Marco Polo to visit a number of places in his empire and describe, as a model, how those cities were. Their discussion is very elusive of the same discussion we hope to have successfully placed in this paper. It is as follows:

"From now on, I'll describe the cities to you." the Khan had said, "In your journeys you will see if they exist."

But the places visited by Marco Polo were always different from those thought of by the emperor.

"And yet I have constructed in my mind a model city from which all possible cities can be deduced," Kublai said. "It contains everything corresponding to the norm. Since the cities that exist diverge in varying degrees from the norm, I need only foresee the exceptions to the norm and calculate the most probable combinations."

"I have also thought of a model city from which I deduce all the others," Marco answered. "It is a city made only of exceptions, exclusions, incongruities, contradictions. If such a city is the most improbable, by reducing the number of elements, we increase the probability that the city really exists. So I have only to subtract exceptions from my model, and in whatever direction I proceed, I will arrive at one of the cities which, always as an exception, exist. But I cannot force my operation beyond a certain limit: I would achieve cities too probable to be real."

"We need a value-based, trans-disciplinary science of society."

We would like to emphasize that in order to deal with the deleterious destabilizing effects of poorly regulated (or unregulated) financial assets and fictitious capital, it is essential to recast the central focus of economic theory and economic programs. In this vein we need deep integration with other disciplines. After all, we live in an increasingly competitive environment (locally, nationally and globally). In other words, we need a value-based, trans-disciplinary science of society. A science anchored in a solid understanding of institutional configurations, visions and dynamics of society.

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