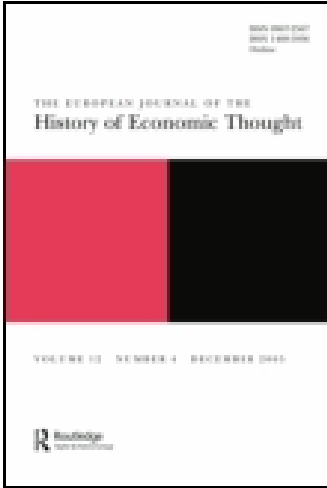


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Hilferding on derivatives

Dimitris P. Sotiropoulos

1. Introduction

Rudolf Hilferding has always been regarded as a leading Marxist scholar. The influence of his ideas can be discerned in other theoretical traditions as well. His major work, *Finance Capital* (1909), became a dominant theoretical intervention at the beginning of the twentieth century and is still considered as a benchmark in the discussions of political economy and heterodox financial theory. Different aspects of his approach have been widely analysed in the relevant literature. Nevertheless, there is one important contribution which has been left untouched: Hilferding's approach to derivatives. The aim of this paper is to fill exactly this gap in literature.

According to the mainstream financial history narrative, futures and options derivatives can be traced back to ancient societies (Markham 2002a: 4–5). However, the role of derivatives in pre-capitalist economies must not be overemphasised. The picture radically changes with the rise and establishment of capitalism; henceforth, the development of financial markets has always been associated with the spontaneous emergence of derivatives of different types. One can refer to many intriguing historical illustrations: primary forms of derivatives on sovereign debt can be found as early as 1390 in Venice; futures contracts were common on the Amsterdam Exchange by 1610, playing a crucial role in the famous Tulip Mania that arose around 1636; put options and 'refusals' (call options) were being widely traded in London by the end of seventeenth century;¹ early forms of securitisation in Geneva no later than the

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¹See Markham (2002a: 265–6). 'The first documented appearance of what are now called puts and calls occurred on the Amsterdam bourse during the tulip mania of the 1630s' (Allen 2001: 44–5).

mid-eighteenth century bolstered the indebtedness of the French monarchy (the coming of the French Revolution deranged the established credit channels, spreading financial panic in the banks of Geneva; see Hoffman *et al.* 2007: 150–1); in 1821, a broker from the London stock exchange complained that the trade in options was ‘now so frequent as to constitute the greater part of the business done in the House’ (cited in Chancellor 2000: 97). Despite all the relevant developments and episodes and despite the fact that at least from the beginnings of the nineteenth-century derivative markets (and especially commodity exchanges) have been growing as an important feature of financial transactions, the discussions in political economy failed to touch even marginally upon the issue of risk trading.²

Hilferding was one of the exceptions to this long theoretical thread of ignorance. He writes in the beginning of the twentieth century when futures markets had been widely established in the developed capitalist economies.³ As we shall see below, his approach is focused on the futures market for tangible commodities, underestimating somehow the role of derivatives on financial securities. But even with this limitation, his embarking upon an analysis of derivatives remains an exceptional theoretical project, not only in the discussions of the period but also in political economy in general. He analyses this development as parallel in importance with the development of the stock exchange. He is able to closely watch financial innovations and changes in the organisation of finance. He lives in Berlin which, as the capital of a newly unified Germany

grew rapidly as a commercial and financial centre, eclipsing Frankfurt as financial capital of the German Empire. [...] The growth of Berlin seemed to be a case of financial power following political power. Banks formerly headquartered in Frankfurt moved to Berlin, and the Reichbank, the central bank of the German Empire, resided in Berlin (Allen 2001: 62).

Hilferding realised very well that the development of the stock exchange which captured the attention of the majority of interventions at the beginnings of the twentieth century – these shifts have been described as the transition to the ‘cult of the common stock’ (Chancellor 2000: 195) or to so-called ‘managerial capitalism’ (a term coined by the well-know intervention of Alfred Chandler; see Baskin and Miranti 1997: 167) – was

²Undoubtedly there are many possible explanations, but these issues fall beyond the scope of this paper.

³See Markham (2002a: 267–9, 2002b: 93–4), Allen (2001: 40–55) and Steinherr (2000).

indeed parallel to another important development: that of the ‘commodity exchange’ (that is to say, the development of organised derivative markets). This idea led him to emphasise the role of the standardised derivative exchanges, especially on the futures markets for tangible commodities. He understood the economic significance that derivative markets have for the organisation of capitalism and made an effort to shed light in their workings by utilising his Marxian analytical background.

This analytical project was rather unusual in the discussions of political economy in the English-speaking world. Nevertheless, in the German theoretical scene, there was an on-going debate on the role of the stock and commodity exchanges at least from the late 1880s.

Debate in Germany over the nature and social impact of stock and commodity exchanges had first grown acrimonious in the wake of the major economic downturn of 1873–1879, which put an end to the boom times of the Empire’s ‘founding era’, as well as the rather spectacular charges of political manipulation and collusion levelled at Bismarck and the German financial elite by a range of conservative and socialist critics. (Lestition 2000: 289)

This debate – which opened the road for government legislation and committees of inquiry (ibid.: 290) – attracted the attention of famous scholars: even Max Weber and Frederick Engels engaged in the relevant discussions.⁴ The main issue which had dominated public discussions at the time was ‘whether it was possible or socially useful to regulate the kinds of “speculation” that were carried on at the exchanges’ (ibid.: 289).

Unlike Engels, Weber along with other social thinkers of the time was influenced by the intervention of Gustav Cohn, professor of public policy at Göttingen. Cohn had publicly opposed the set of alternatives offered by both the Social Democrats and Marxists ‘either to accept wholly the monopolistic power and fluctuating play of speculation of capitalists seeking profits, or to shift to its polar opposite – the collectivist vision of an expropriation of the power of private capital for the sake of general social welfare’ (ibid.: 299). Quite contrary to both perspectives, the true alternative for Cohn was either to accept, on the one hand, the exchanges along with their innate tendency for speculation, not as a divergence but rather as ‘a necessary organ of the contemporary society rooted in private capital’, or on the other hand, to decide to ‘abolish the ownership of private capital entirely’ (cited in ibid.: 299). As we shall see in Sections 2 and 3, this

⁴For instance, see Weber (2000). At the same time, in a paper published in 1880, Engels wrote: ‘the German Empire is just as completely under the yoke of the Stock Exchange as was the French Empire in its day. It is the stockbrokers who prepare the projects which the Government has to carry out – for the profit of their pockets’ (Engels 1989: 280).

conception of speculation influenced Hilferding to some extent, determining his viewpoint on derivatives. In fact, speculation is understood by him not as a distortion of capitalism but as the ‘most legitimate offspring of the basic capitalist spirit’ (Hilferding 1981: 167). In this sense, the real dilemma is not between different regulated forms of capitalism but between capitalism and socialism.⁵

Regardless of how one appraises the final outcome of Hilferding’s analysis, his intention to incorporate the futures market in his general approach and analyse it using Marxian theoretical categories is quite exceptional in the long tradition of political economy. Unlike the theoretical interventions in the English-speaking world of the time, Hilferding under the influence of German-speaking debates realised the importance of commodity exchanges (derivatives) in the organisation of capitalism. Unfortunately, this part of his work has passed totally unnoticed.

In what follows, the paper will present Hilferding’s viewpoint on derivatives. In Section 2, I shall discuss how he sees the economic role of futures markets in the dynamics of capital. In Section 3, his reasoning with regard to the practice of speculation will be stressed. Not only does he attribute a positive economic role to speculators but also he reckons them to be a fraction of the capitalist class. In Section 4, we shall see how he associates derivatives markets with his general perspective on finance capital. And finally, in Section 5, I shall discuss and appraise his view on derivatives, arguing that he actually sees them as a new form of money which could become redundant only in the context of the formation of gigantic monopolies. From this point of view, his analysis is indeed a forerunner of many contemporary approaches.

2. The economic role of futures markets: Hilferding’s general viewpoint

Chapter 9 of *Finance Capital* is totally devoted to ‘the commodity exchange’ (Hilferding 1981: 151). To use contemporary terminology, the model of the market that Hilferding had in mind was that of standardised futures

⁵To what extent Hilferding was actually inspired by Cohn’s perspective remains an open question to be addressed in future research. It is clear that Hilferding do not quote Cohn directly but only indirectly from the ‘Börsen-Enquete-Kommission’ reports. In the chapter dealing with futures, Hilferding refers many times to the reports published by the ‘Börsen-Enquete-Kommission’, i.e. the commission which was established in 1892 and focused on the commodity exchanges (with speculation being one of the main issues). The linkage between the approach to speculation of these reports and Hilferding’s line of reasoning is another open question for future research.

contracts in tangible commodities wherein contracts are held until maturity (ibid.: 152). This is a rather simplified version of a futures market. Normally in the latter, the majority of the positions held actually close out prior to delivery. This is true for futures markets now as well as at the beginning of the twentieth century.⁶

Hilferding is also totally aware of the ‘futures operations in the securities business’, but he rather underestimates their economic role arguing that ‘the futures business, while it facilitates the trade in securities, is not essential to it, and has no decisive influence upon prices’ (ibid.: 152, 151). On the contrary, he believes that the case of commodities futures is quite different: they are essential to the commodity trade and price formation (ibid.). In this sense, he believes that commodity exchange procedures are really close to those on the stock exchange. In fact, this is probably the main real reason why he included a chapter on futures derivatives in his book.

According to Hilferding, the basic reason for the existence of futures markets on tangible commodities is to deal with price risk. This type of risk comprises two components. First, there is as usual a serious mismatch between the ‘time of production’ and the final selling point of the commodity (‘the short period of production as against the long circulation time resulting from continuous consumption’, ibid.: 152); while second, during this time period, there can occur unexpected price fluctuations beyond the control of any business (ibid.: 152–3). In this regard, the great benefit from futures markets is that there now exists a price:

[...] *for every instant of the year.* It thus gives manufacturers and merchants the possibility of avoiding the unforeseen consequences of price movements, of protecting themselves against price fluctuations [...]. *Futures trading is thus a means by which industrialists and merchants can confine themselves to their proper function.* A part of the reserve capital which would otherwise be needed as an insurance against such price fluctuations, and thus tied up in industry or commerce, is thereby set free. [...] Futures trading saves the producers circulating capital, first by reducing the circulation time, and second by reducing their self-insurance (reserve fund) against price fluctuations. [...] The capital which is thus set free becomes productive capital (Hilferding 1981: 156, 161; emphasis added).

In this sense, the benefit for capitalists (industrial and merchants⁷) is twofold. On the one hand, knowing future commodity prices, they are

⁶There is no reason to make the rather costly and inconvenient delivery. Both counterparties net out their positions, realising gains and losses, and if they still want to buy or sell the underlying commodity they go to the spot market. Clearinghouses have always played an important role in offsetting opposite positions in the market (Markham 2002b: 105).

⁷Hilferding adopts the viewpoint that while the capital used by merchants yields an average profit, this profit ‘is simply part of the profit generated by industrialists in

protected against unexpected price fluctuations in both their means of production and their final product. Hence, they can better control the production and realisation of surplus value confining 'themselves to their proper function'. At the same time, there is another equally important benefit related to the latter one. According to Hilferding, since unforeseen price fluctuations in the process of circulation have drastic consequences in the production and realisation of profits (ibid.: 157), in the absence of futures markets, the capitalists 'must maintain reserves which will enable them to cover losses arising from price fluctuations, and to continue their production without interruption' (ibid.: 158). This 'insurance' reserve fund should be considered as part 'of the necessary circulation capital' (ibid.). The existence of futures markets sets free this part of circulating capital, allowing it to be invested in some other productive activity.⁸

There are two major shortcomings in Hilferding's argument so far. First, according to him, since the withheld reserve fund is part of the invested capital 'an average rate of profit is calculated for it' and 'the profit imputed to it may therefore be regarded as the risk premium' (ibid.: 158). In other words, the capitalist gets protection for free, which is not what actually takes place. Let us see why. The capitalist withdraws the self-insurance reserve fund from an alternative productive use. In this sense, she bears a cost for giving up the profit she would have gained in the case she did not hedge against market risk.⁹ In plain terms, this is exactly the 'risk premium' she must 'pay' to buy protection: the profit she would receive for not hedging. If she chooses to hedge she has to abstain from the alternative profit and this is exactly the cost she has to bear in order to buy protection or get rid of the risk. However, according to Hilferding, she ends up receiving the

the process of production, that is, a *pro tanto* (proportional) deduction from the profit which would otherwise accrue to industrialists' (Hilferding 1981: 170). This is the dominant reading of Marx's approach even in our day. Nevertheless, it must be stressed that there is also an alternative reading of Marx (for instance, see Milios *et al.* 2002; Heinrich 2005).

⁸Hilferding's account of risk is rather poor. In brief, he seems to consider risk as the 'certainty that the profit which originates in production will actually be realised in circulation' (Hilferding 1981: 157). This general description implies risk in circulation. Nevertheless, Hilferding's analysis also allows for another type of risk: risk in production ('which results from a change in the conditions of production', ibid.: 158). This second type describes unfortunate events that may occur during the production process while the first amounts to what we may call market risk. Hilferding argues that futures market can 'insure only against those fluctuations which arise in the course of circulation' (ibid.). Therefore, he restricts his analysis in focusing on market risk which is mainly associated with futures on tangible commodities. Nevertheless, this is not the most important aspect of risk in capitalism and of course derivatives in general deal with many different broad categories of risk.

⁹We do not take into consideration the 'productive' benefits from this reserve fund.

very same amount of profit she gave up in the first case. This means that she buys protection for free, which does not make any sense. The capitalist does not receive any new absolute profit when she adds the self-insurance reserve fund to circulating capital. She just loses the profit that would have been imputed to the fund if she did not withdraw it from the alternative productive use. As a result, less profit is earned on the same amount of capital, and the capitalist faces a reduction in her total profitability.

On the other hand, and in relation to the above point, there is always a cost for being involved in the so-called market for risk. Therefore, the benefit that the capitalist receives when reserve capital is set free is always combined with a cost for participating in the futures market. Hedging even in standardised futures markets requires some investment in risk management, which will absorb at least a part (if not the total) of the initial self-insurance reserve capital. Moreover, hedging stabilises future production costs and revenues but the firm is not always better off in terms of profitability. In other words, futures hedging has a cost as well. An over-hedging strategy may easily lead to highly fluctuating profit margins. Hence, setting forth a hedging strategy is a very difficult and demanding task. Hilferding seems to underestimate these difficulties and oversimplify the workings of derivative markets. He does not see that engagement in futures markets is also costly and requires reserve funds of different types as well.

Hilferding seems to be confused about the workings of derivative markets. But this was a rather general problem. While the organised derivative exchanges along with sophisticated financial strategies were fully established at the beginning of the twentieth century,¹⁰ the development of financial theory was relatively poor even in mainstream discussions. Bachelier's attempt in his doctoral thesis to introduce probability in the description of security price movements and to put forward an option pricing formula was left unnoticed until the 1950s (when it was rediscovered by Samuelson in the library of the University of Paris). Irving Fisher's writings on financial theory embodied the slow progress in the field, and only dealt with elementary issues; they did not attract any serious attention before 1930s.¹¹ The theoretical production at the beginning of the twentieth century is far behind the development of contemporary

¹⁰See Markham (2002b) and Obstfeld and Taylor (2004).

¹¹In brief, Fisher puts forward the 'first formal equilibrium model of an economy with both intertemporal exchange and production' (Rubinstein 2006: 55); and a rough version of the random walk hypothesis (Fox 2009: 13). His 1930 book – entitled *The Theory of Interest: As Determined by Impatience to Spend Income and Opportunity to Invest It* – actually refines and restates his earlier theoretical outcomes.

financial theory and the analysis of derivative markets did not attract interest in theoretical discussions outside the German-speaking world.

Nevertheless, in spite of the general theoretical fashion, Hilferding not only understands the importance of the derivatives markets in the organisation of capitalism but also sees very well the general economic gains from the existence of futures markets along the lines of contemporary financial reasoning. For him, future markets do not foretell the future accurately: 'in reality, futures prices are purely speculative' (see below). But this is not the main issue with the derivatives markets. Of course, many capitalists and speculators would be ready to pay a fortune for the 'correct' spot prices in the future. Futures markets do not provide that sort of information. At the time of the investment decision, the capitalist is able to make an investment choice based on the quoted futures prices no matter how close the latter will be to the actual spot prices in the future. The capitalist is able to calculate the future profit abstracting from the market fluctuations. She cannot know the exact spot price in the future, but the futures markets render that information redundant¹²:

In reality, *futures prices are purely speculative*. [...] The reason for wishing to know futures prices is that the processing industry must know the price of its raw materials when it has to make tenders. If the raw material season does not coincide with the time when the processing industry orders materials, it will need to know futures prices, especially in the case of commodities subject to sharp price fluctuations (Hilferding 1981: 166; emphasis added).

In this sense, capitalists can smooth out their calculations on future profitability focusing exclusively on how to achieve more efficient exploitation of labour (as mentioned above). There is only one institution than can make futures markets unnecessary: the monopoly combines. For Hilferding, business syndicates can use 'their power to free themselves of this risk, either by maintaining stable prices, or by setting futures prices so high that in that way too they avoid all risk' (ibid.: 166). In this fashion, monopolistic combines can also be seen as *substitutes* to risk trading; their development 'is eliminating the commodity exchanges' (ibid.: 163). This line of reasoning, possibly a reflection of the development of capitalist monopolies at the time of Hilferding, permits an unorthodox form of risk management. Hilferding's intervention invites us to reconsider the roots of the development of monopolies during this highly internationalised phase of capitalism.

¹²This is the dominant contemporary argument (see Steinherr 2000: 100–2; Bryan and Rafferty 2006).

3. Speculators and speculation: the innate spirit of capitalism

Quite contrary to what one might have expected from him, Hilferding sees a positive role in speculation activity in futures markets. More than that: he perceives speculators as a specific fraction of capitalist class. This is based on a particular approach to speculation that must be highlighted.¹³

In Hilferding's reasoning, speculation is synonym for arbitrage. It is the search for 'marginal profit' out of proper positions in the futures markets to take advantage of existing 'price differences'. For the class of speculators, this type of economic activity amounts to a zero-sum-game:

The futures trade is the most satisfactory form for all speculation, since every kind of speculation is a way of taking advantage of price differences which occur over periods of time. Speculation is not production, and since time represents a sheer loss to a speculator unless he is engaged in buying or selling, he must be able to exploit immediately all price differences, including those which will occur in the future. He must therefore be able to buy or sell at any moment, for any future moment of time, and this is precisely the essential characteristic of futures trading. [...] This sequence of purchase and sale transactions is purely speculative; its object is to reap a marginal profit. These are not commercial operations, but speculative dealings. The categories of purchase and sale do not have the function, in this case, of circulating commodities, or moving them from producers to consumers, but have taken on an imaginary character. Their object is the acquisition of a marginal point. The price of a commodity which a merchant sells on the exchange already includes the normal trading profit. [...] The exchange, however, buys and sells in a purely speculative fashion, and speculators make a marginal gain, not a profit. If one gains, another loses (Hilferding 1981: 156, 154).

As we see, in Hilferding's reasoning, the activity of speculation pertains to its own terms and patterns, always winding up as a zero sum game. It has also a major economic by-result: it generates future prices and smoothes out market fluctuations by 'creating smaller and more frequent oscillations' (ibid.: 156). This process is associated with 'a specific class of capitalists, the speculators, [...] who assume the burden of these price fluctuations' (ibid.: 157). In Hilferding's argument, speculators comprise a distinct fraction of the capitalist class that receives a particular type of profit. The latter differs from industrial and commercial profit. As mentioned above, it is a form of a 'marginal profit' which originates from properly structured arbitrage positions. Since, 'the profit of one speculator is the loss of another [...] professional speculators only thrive when large number of outsiders participate in speculation and bear the losses. Speculation cannot flourish

¹³We have to mention that the same idea about speculation was also applied by Hilferding to the analysis of the stock exchange. According to his logic: 'the specific activity of the stock exchange is really *speculation*' (Hilferding 1981: 134).

without the participation of the “public” (ibid.: 157, 158). This insight has three important consequences which will be analysed in brief.

First, Hilferding believes that speculators bear all the market risks, leaving industrialists and merchants focused solely on their productive activities.¹⁴ This is wrong because futures markets transfer risk from one party to another but they do not eliminate it (on the contrary, sometimes they even ‘create’ more). Every derivative contract requires two initial opposite positions (a ‘short’ and a ‘long’ one). Whatever the number and the size of the intermediating arbitrage or speculative bets, there will always be an ‘initial’ and a ‘final’ short and long position. Intermediaries cannot absorb all the traded risk. In fact, as we see below (Section 5), the real function of derivatives markets is that they commodify different types of risks, letting them be bought and sold by counterparties with opposite risk profiles and ‘appetites’.

Second, Hilferding has linked the existence of speculators (as a fraction of the capitalist class) to a marginal profit. But since, in his reasoning, the futures market is a zero sum game (‘the profit of one speculator is the loss of another’), the total profit of the fraction of speculators must be equal to zero (at least as a tendency). Hilferding understands that it is contradictory to hoist the existence of speculators on a principle of no-total-profitability. That is why he argues that speculators thrive only when there is a large number of non-professional ‘outsiders’ that finally bear the losses. In this sense, despite the fact that the total profit from speculation is zero, the capitalist faction of speculators as a whole ends up with a positive profit because the inexperienced ‘public’ bears all the final losses (relieving therefore industrial and commercial capitalists from the price risk in his argument). In fact, this amounts to income redistribution through the financial markets to the benefit of all fractions of the capitalist class, but especially of speculators.

Third, the participation of the public adds to the instability of the markets. As we saw above, Hilferding believed futures markets smooth out price fluctuations causing more frequent but smaller price changes. In this setting, there is hardly any room for crises. Nevertheless, ‘this does not prevent one speculative trend – for example, a “bullish” trend – from becoming dominant for a time, and so long as this trend persists the price will be higher than the actual trading in goods would dictate’ (ibid.: 159).

¹⁴Once more, he repeats: ‘by reducing the circulation time for productive capitalists, and assuming the risks, speculators can have an effect upon production itself’ (Hilferding 1981: 161). In this fashion, the ‘most important function’ of futures market is ‘the possibility of insuring oneself by unloading the losses due to price fluctuations upon the speculators’ (ibid.: 159).

Hilferding does not analyse the consequences from such a bullish trend in the market. His argumentation makes some room for the existence of crises in the futures markets; nevertheless, he mostly stresses their economic benefits, underestimating the instability that they might cause. He seems firmly convinced of the stabilising role of speculation.¹⁵

Hilferding's point with regard to speculators derives from this general outlook towards speculation in capitalism. In fact, he apprehends speculation as completely *rational* economic behaviour in the context of the circuit of capital. Speculation is an activity of seeking for a marginal profit; however:

the pure margin business is actually the most complete expression of the fact that for the capitalist only exchange value is essential. *The margin business is indeed the most legitimate offspring of the basic capitalist gain.* It is business-in-itself, from which the profane phenomenal form of value – the use value – has been abstracted. It is only natural that this economic thing-in-itself should appear as something transcendental to non-capitalist epistemologists who, in their anger, describe it as a swindle. *They do not see that behind the empirical reality of every capitalist transaction there stands the transcendental business-in-itself, which alone explains the empirical reality [...]* Exchange value determines the whole of economic action, the aim of which is not the production or supply of use values, but the achievement of profit (Hilferding 1981: 167–8; emphasis added).

For Hilferding speculation appears as irrational ('swindle') only to those who are unable to grasp the real social nature of capitalism, which is not the production of use value but profit.¹⁶ In capitalism, only exchange value is essential. As long as use value is abstracted, every profit seeking activity including speculation – every 'business-in-itself' – is just a legitimate reflection of the capitalist spirit. Those who cannot see this outcome – attempting to radically distinguish speculators from other capitalist

¹⁵The analysis of this paper is focused on the particular part of *Finance Capital*. In other parts of the latter, Hilferding revisits the issue of speculation offering additional grounding for the same line of thought. For instance, in chapter 20, he argues that the 'mass psychoses which speculation generated at the beginning of the capitalist era [...] came to an end in the crash of 1873. Since then, faith in the magical power of credit and the stock exchange has disappeared' (Hilferding 1981: 294). In this respect, losses from crises make the public wiser and as a result speculation becomes less destabilising, at least at the period after the crisis of 1873. We see that the reasons offered to downplay the destabilising role of speculation are much wider than those mentioned in the section of the book devoted to futures. It is obvious that this type of reasoning is not able to explain recent developments in capitalism.

¹⁶From this point of view, he seems to agree both with the reasoning of Weber and Cohn with regard to the issue of speculation and how it is interlinked to the logic of capitalism (see Lestition 2000: 299; Weber 2000: 309–10).

business – are just unable to apprehend the real nature of the capitalist mode of production. Speculation is not some sort of ‘distortion’ of an ideal capitalist type; it is indeed ‘the most legitimate offspring of the basic capitalist spirit’. That is exactly why Hilferding defines speculators as a fraction of the capitalist class.

This conclusion is in accordance with Hilferding’s general view of finance capital. In brief, finance capital is a fictitious form of the ownership over capital (the ‘pure’ form of ownership) when this form is disposed and controlled by the banking system. In other words, the finance capital is a fictitious capital when the latter is, to significant extent, taken over by the banking system, leading open markets to fade away (ibid.: 149, 225). This amounts to a particular form of institutional organisation of the financial system. In this sense, the investment in stock or commodity exchange becomes a ‘business-in-itself’ detached from the sphere of production. According to Hilferding, this is not a distortion of capitalism, but its highest development. The ownership of the capital in the economy is concentrated in the portfolios of gigantic banks. The managers of these portfolios aim at higher values (or more gains) and this must not be considered as a divergence from the true spirit of capitalism, but as the latter’s very essence. Hilferding indeed devoted a significant part of his book to explain how this new financial development is linked to the organisation of the surplus value production (as a process of exploitation, of course). One could argue that his analysis has many limitations, mostly because the monopoly structures and the predominance of banking intermediation in the financial markets must not be taken for granted: they do not pertain to the social nature of the capital relation.¹⁷ Nevertheless, setting that aside, his intervention is indeed ingenious because it invites a new way to think about capitalism: *as a system of exploitation that is associated with an active portfolio management process*.¹⁸ This is the real question involved in the project of finance capital. If balance sheet management is to be seen as speculation, then this speculation is not a distortion but a legitimate reflection of the purest spirit of capitalism. This line of reasoning is also very important for the understanding of contemporary capitalism as well.

¹⁷For instance, see Milios and Sotiropoulos (2009).

¹⁸The idea of finance capital is indeed a notion of banks controlling the capital titles which exist as financial securities. In general, this is a ‘portfolio management’ type of reasoning, whatever the criteria of this management (and it is clear that for Hilferding institutional criteria other than profit maximisation may also be taken into account). In this section, I suggest a reconsideration of Hilferding’s viewpoint, which must also be read in the context of a broader understanding of *Finance Capital*. This theoretical agenda exceeds the scope of this paper.

4. The future of derivatives in the era of finance capital

So far we have analysed futures markets independently of the general institutional shifts stressed by Hilferding, namely the rise of monopoly capitalism and the dominance of finance capital. We did so because we wanted to isolate Hilferding's reasoning on derivatives and put it in a more general context. It is well known that Hilferding's main effort was to describe the changes in capitalist society that were brought about by the more intimate relationship between bank and industrial capital in the so-called monopoly phase of capitalism. In this line of thought, there emerges the 'supreme and most abstract expression' of capital in the form of finance capital (Hilferding 1981: 21). In this section, we shall see how this trend is reflected on derivative markets according to same reasoning.

Hilferding understands that a futures contract before maturity 'becomes suitable as a security for money which is temporarily idle' (*ibid.*: 154). Of course, he overlooks the fact that this is true only for those positions that make a gain in relation to the current trend of spot and futures prices. Nevertheless, he realises that given the liquidity of futures markets, derivatives can easily become interest-bearing securities attracting the capital of banks from alternative interest-bearing investments (*ibid.*: 154). Moreover, banks also support the liquidity of the market: they provide credit to speculators allowing them to embark upon leveraged positions and make gains out of narrow price differentials. For Hilferding, this further stabilises the trend of prices to the benefit of industrial capitalists.¹⁹

It seems that there is absolutely no impediment for banks to engage in the activity of speculation. In order to become more competent as speculators, banks also attempt to control the circulation of commodities, taking over gradually 'the place of the merchant in relation to the industrialist' (*ibid.*: 162). This development brings banks even closer to industry, extending dominance of the former upon the latter:

once the bank has control of the marketing, the mutual relations between the bank and industry become closer. The bank's interest in the price of the commodity is no longer exclusively that of a speculator; it desires a high price in the interest of the enterprise with which it has all kinds of credit connections. At the same time, since the bank wants to acquire the greatest possible control over the commodity, it seeks connections with as many enterprises as possible, and so acquires an interest in an entire branch of industry. The bank's interest, therefore, is to protect this branch of industry as much as possible against the impact of a depression, and so it will use its influence to accelerate the process of cartelization, which will, to be sure, make the

¹⁹We see here that, once again, Hilferding dissociates speculative leverage from crises in the derivative markets. According to his logic, more speculation leads to more price stability (Hilferding 1981: 155).

bank's speculative activity on the domestic market (though not on the world market) superfluous, but will amply compensate it by participation, in various ways, in the cartel's profits (ibid.: 162).

There are two main findings in the above passage. On the one hand, the engagement of bank capital in the futures market motivates it to gradually 'replace commercial capital in carrying out a part of the commercial functions' (ibid.: 169). This expansion of the investment sphere for bank capital imposes the fictitious form upon commodity circulation as well. Futures markets have become important investment destinations of interest-bearing capital. We also know that in Hilferding's train of thought, the profitability of commercial capital stems from the surplus value initially produced in the industrial sphere. As an immediate consequence, the replacement of commercial capital by banks raises industrial profitability because bank capital (as interest bearing capital) receives a regular interest rate for the same operation for which commercial capital used to get a regular rate of profit. Therefore, banks' dominance over commerce absorbs less surplus value from the class of industrial capitalists (ibid.: 169).²⁰

The final result of banks' involvement in the futures markets is the gradual negation of these markets. The formation of monopolistic combines establishes fixed and stable long-run prices. In the absence of price fluctuations, speculation (in Hilferding's definition) becomes totally redundant. There is also no need for a futures market in the first place since price risk has to a significant extent disappeared (ibid.: 163). Thus, in the era of finance capital 'futures trade encourages a development, which is in any case a general trend, that culminates in the elimination of the futures trade itself' (ibid.: 163). In this regard, monopoly capitalism undermines derivatives markets. But then, one could also argue the opposite: the rise of international competition brings derivatives markets to

²⁰Of course, this is a result stemming from Hilferding's line of reasoning which accepts that only industrial capital is 'productive' and that every type of fictitious capital yields the ordinary interest rate. We shall not elaborate on these issues, but it is not necessary to agree with the first while the second is rather a misleading oversimplification of the dynamic character of capitalist reality. More generally, many of Hilferding's analytical shortcomings may be explained by its adherence to the Ricardian labour theory of value, the erroneous perception of industry as the only productive activity that generates surplus value, and finally, his great mistake in considering capitalist competition as a temporary element of capitalist mode of production. For critical comments on these issues, see Milios and Sotiropoulos (2009).

the fore. With this little twist, the argument of Hilferding still remains live in contemporary capitalism.

5. Hilferding's general conception: derivatives as a new form of money

In this last section, I shall make a more general point concerning Hilferding's argumentation. Regardless of the abovementioned shortcomings in his reasoning, he attempts to approach derivatives from a general perspective, putting forward the thesis that they become *a new form of money*.²¹ In what follows this point will be explained and assessed in the context of contemporary discussions. Conceiving derivatives as a form of money is exceptional at the time of his writings. Hilferding aims at the core logic of finance. In this regard, his intervention raises important issues even for the understanding of contemporary financial developments. Hilferding ended up arguing that the dominance of finance capital (i.e. the fictitious capital controlled by the gigantic banks) under the conditions of monopoly capitalism tends to eliminate derivatives markets. One of the reasons for this result is that monopolistic combines can be seen as particular institutional arrangements for dealing with risk in an internationalised economic environment (that of the beginning of the twentieth century).²²

Attempting to generalise his approach, Hilferding comes to the following conclusion with regard to derivatives (futures contracts in particular, but this thesis can be easily generalised):

The distinctive feature of commodity exchange trading is that [...] it makes the commodity, for everyone, a pure embodiment of exchange value, a mere bearer of price. [...] In futures trading, therefore, the commodity is simply an exchange value. It becomes a mere representative of money, whereas money is usually a representative of the value of a commodity. The essential meaning of trade – the circulation of commodities – is lost, and along with it the characteristic of, and the contrast between, commodity and money (Hilferding 1981: 153; emphasis added).

²¹Bryan and Rafferty have recently put forward an influential intervention on the same point. Their assumption is that derivatives serve as a new form of global money, playing 'a role that is parallel to that played by gold in the nineteenth century': the role of 'anchor to the financial system' (Bryan and Rafferty 2006: 133). Another approach that meets to some extent with the argumentation of Hilferding is the one offered by Rotman (1987).

²²According to Hilferding, there were other important causes for the establishment of monopoly capitalism. Nevertheless, the existence of monopolistic combines obviated the need for risk management (see Section 2). For a general presentation of Hilferding's point with regard to the monopoly capitalism and a critique of it, see Milios and Sotiropoulos (2009: ch. 9).

How shall we understand the above passage? According to Hilferding, derivatives markets provide a new manifestation of the commodity form: as a pure exchange value without any reference to use value at all; commodity as 'a mere bearer of price'. This is indeed a very mysterious abstract existence. In fact, the underlying commodity is not part of the derivatives markets. Instead of the commodity itself, derivatives markets encompass an abstract reflection of it, generating a duplicate appearance totally independent from any use value specification. Therefore, quite contrary to 'ordinary' commodity spot markets where money represents the value of a commodity, in derivatives markets, the futures contract becomes itself a 'representative of money' and *thus exists as a monetary form in the sense that it now measures-reflects the value of the underlying commodity*. In this line of reasoning, derivatives become a new form of money.

This theoretical statement was not explicitly made by Hilferding, but the reformulation here does not violate his theoretical problematic. According to the latter, money must necessarily be a commodity; gold's natural attributes secured its historical role as money. Hence, money represents something that already exists as a property of commodities: their value (see Hilferding 1981: 34–6). In the above passage, it is clear that Hilferding believes that the independent existence of value can be equally represented by futures, since the latter represents money, which itself represented value in the first place. In other words, futures are a type of 'second-order' representative of value and therefore necessarily play the role of money. This type of reasoning brings the status of derivatives close to that of credit money. In Hilferding's analysis, credit is a successful and convenient substitute for money: it performs the 'work of money' by replicating its functions (*ibid.*: 82–3). In this fashion, credit money is not money in a strict sense but it represents it. In quite the same manner, one could argue that futures are not money in the strict sense but a type of substitute for it. Futures like credit cannot be called money but they do retain a status of 'moneyness' in this line of reasoning.

From this point of view, Hilferding's argument can be reformulated in general terms as follows. For single commodities, the 'marketability and hence their convertibility into money at any time is assured because they have a world market' (*ibid.*: 153). The only problem is that the unexpected price fluctuations make the ordinary money form rather insufficient as a reliable measure of value given the difference between the 'short period of production as against the long circulation time resulting from continuous consumption' (*ibid.*: 152). The establishment of derivatives markets reinstates the missing stability by inventing a new form of monetary expression that is more stable in the role of the measure of value. Since the production process is a time-consuming procedure that extends

internationally, derivatives markets render the capitalist able to assess the value terms of production inflows (means of production and labour power) and outflows (final product) associated with the circuit of the individual capitalist enterprise $M-C-M'$ at every point of time and space.²³ For instance, the capitalist is able to know in the present the future price of its distanced exports and imports, having got rid of the market risk. Now the capitalist can totally focus on the production of surplus value. This information is the result of the futures contracts as mere bearers of price.

This line of reasoning establishes a new way of approaching derivatives markets. According to Hilferding, they set up a new measure of value to overcome price risk. This opens up fertile ground to rethink recent financial developments. It parts with explanations that associate derivatives with irrational behaviour and attempts at considering derivatives as markets in structural terms. Hilferding realised quite early the economic significance of derivatives markets for the organisation of capitalism and attempted to deliver a proper theoretical explanation for their existence, unique in the discussions of his time.

There is one theoretical problem which must be emphasised. *Derivatives do make a difference; but as sui generis commodities and not as money.*²⁴ They are themselves financial contracts that bear a money price. Hilferding was not able to see this dimension because he erroneously thought, as mentioned above, that derivatives markets totally annihilate risk. In that case, derivatives might be considered as forms of money because they would bear a price without trading something. Nevertheless, derivatives markets do not eliminate risk. They commodify and trade it: risk is singled out of the underlying commodity, sliced up, parcelled out and repackaged to a new isolated commodity form which now acquires a price. Therefore, derivatives markets transfer and price risk. Contrary to Hilferding's reasoning, derivatives contracts are not 'mere bearers of price'; they are sui generis commodifications of risk. This development has important implications for the organisation of capitalism. In brief, derivatives markets are, to put it simply, organised in such a way that a net quantity of value emerges along with the isolation and packaging of a known concrete risk. This quantity is measured in money. As a result, because of the interposition of the notional exchange of the derivative with money, one particular and case-specific risk *can be regarded as the same as any other*. Hence, derivatives markets set up the dimension of abstract risk by making different concrete risks commensur-

²³This is the well-known formula that describes the circuit of capital in Marx's argumentation (M stands for money and C for commodity).

²⁴For this line of reasoning, see Sotiropoulos *et al.* (2012) and Sotiropoulos and Lapatsioras (forthcoming).

able.²⁵ The form of abstract risk is a risk measured in value, that is to say, money. Abstract risk is a mediating factor enabling different concrete risks to become social and commensurable to each other.

Hilferding's reasoning in spite of the abovementioned contradictions and shortcomings invites a distinctive approach to the process of speculation and financial innovation. The former (speculation) is 'the most legitimate offspring of the basic capitalist spirit', while the latter (derivatives) is best understood in terms of Marxian value form analysis. In this fashion, contemporary financial developments can be thoroughly grasped only when they are linked to the circuit of capital. Regardless of its weaknesses, Hilferding's text conveys a strong message for the understanding of contemporary capitalism in the context of the Marxian framework.

6. Conclusions

The analysis of the paper has attempted to present Hilferding's argument on derivatives. This aspect of his approach has not received proper attention in the relevant discussions. The paper aims at filling this gap in the literature.

Despite weaknesses in his approach, Hilferding puts forward four important issues with regard to the financial system. First, developments in the stock exchanges are parallel to similar developments in commodity exchanges. His analysis suggests that the focus solely on the first misinterprets the real changes in the financial landscape. The emergence of derivatives is always to some extent interlinked to the growth, development and expansion of finance. Second, speculation is not an activity that distorts the hypothetical true essence of capitalism if the latter is to be perceived as a system of exploitation. Speculation is part of the essence of financial markets in general. It is the 'most legitimate offspring of the basic capitalist spirit' implying that 'for the capitalists only exchange value is essential'. Third, he therefore realises that the true challenge for the analysis of the modern and developed form of capitalism is to understand how this activity of 'speculation' enhances and organises the exploitation of labour. The analysis he sets forth is not promising in this line, but it does address the real question. Speculation as the real nature of portfolio management (the search for more value) is associated with the

²⁵For the issue of abstract risk, see LiPuma and Lee (2004), Sotiropoulos *et al.* (2012) and Sotiropoulos and Lapatsioras (forthcoming). For an interesting perspective on derivatives, see also Bryan *et al.* (2009) and Martin (2007).

organisation of capitalist production; it is not opposed to it and only marginally deranges it. Finally, he apprehends derivatives as a new form of money since they become a 'contractual' expression of futures prices. As mentioned above, this approach to derivatives is insufficient for the understanding of their workings; but at least it is an approach that raises important issues, suggesting that the role of these markets must not be underestimated. In this regard, Hilferding's analysis remains crucial for discussions of contemporary economic developments.

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Abstract

Rudolf Hilferding has always been regarded as a leading Marxist scholar. His theoretical intervention is still considered to be benchmark in Political Economy. Nevertheless, Hilferding's approach to derivatives has been left untouched. The aim of this paper is precisely to fill this gap in the literature. Hilferding realised that the development of the stock exchange was indeed parallel to another important event: the emergence of standardised derivative exchanges; he underlined their economic significance for the organisation of capitalism. In spite of how one appraises the final outcome of his analysis, the intention to incorporate futures markets in his general approach and to analyse them using Marxian theoretical categories is quite exceptional in the long tradition of political economy.

Keywords

Hilferding, Marx, finance, derivatives