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HILFERDING ON DERIVATIVES

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Abstract

Rudolf Hilferding is a leading Marxist scholar. But Hilferding's approach to derivatives has been left untouched. The paper aims at contributing to the literature. Hilferding realized that the development of the stock exchange was parallel to the development of standardized derivative exchanges. Hilferding understood the economic significance that derivative markets have for the organization of capitalism. The intention of incorporating the futures market in his general approach using Marxian theoretical categories is significant in the long tradition of political economy.

Keywords: Hilferding; Marx; finance; derivatives.

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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.¹ His major work, *Finance Capital* (1909), became a dominant theoretical intervention at the beginning of the 20th century and is still considered as a benchmark in discussions of political economy and heterodox financial theory. Different aspects of his approach have been widely analyzed in the relevant literature. Nevertheless, there is one important contribution which has been unexpectedly 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, pp. 4-5). However, the role of derivatives in the pre-capitalist economies must not be overemphasized. The picture radically changes with the rise and establishment of capitalism and henceforth the development of financial markets has always been associated with the spontaneous emergence of derivatives of different types. For instance, 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 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 17th century;² early forms of securitization in Geneva no later than the mid 18th century boosted the indebtedness of the French monarchy (the coming of the French Revolution deranged the established credit channels, spreading financial panic in the banking of Geneva; see Hoffman, Postel-Vinay, & Rosenthal, 2007, pp. 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, p. 97). Despite all

the relevant developments and episodes and despite the fact that at least from the beginnings of the 19th century derivative markets (and especially commodity exchanges) are growing as an important feature of financial transactions, the discussions in political economy failed to touch even marginally upon the issue of the risk trading.³

Hilferding was one of the exceptions to this long theoretical thread of ignorance. He writes in the beginning of the 20th century where futures markets have been widely established in the developed capitalist economies.⁴ 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 the political economy in general. He analyzes this development as parallel in importance with the development of the stock exchange. He is able to closely watch financial innovations and the changes in the organization of finance. He lives in Berlin which as capital of 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, p. 62).

Hilferding realized very well that the development of the stock exchange which captured the attention of the majority of interventions at the beginnings of the 20th century – these shifts have been described as the transition to the “cult of the common stock” (Chancellor, 2000, p. 195) or to the so-called “managerial capitalism” (a term coined by the well-know intervention of Alfred Chandler; see Baskin and Miranti, 1997, p. 167) – was indeed parallel to another important development: that of the ‘commodity exchange’ (that is to say, the development of organized derivative markets). This idea led him to emphasize the

role of the standardized derivative exchanges, especially on the futures markets for tangible commodities. In this fashion, he understood the economic significance that derivative markets have for the organization of capitalism and made an effort to shed light in their workings by utilizing the 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, p. 289). This debate – which opened the road for government legislation and committees of inquiry (Lestition, *ibid.*, p. 290) – attracted the attention of famous scholars: even Max Weber and Frederick Engels engaged in the relevant discussions.⁵ The main issue which had dominated public debate at the time was “whether it as possible or socially useful to regulate the kinds of ‘speculation’ that were carried on at the exchanges” (*ibid.*, p. 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” (Lestition *ibid.*: 299). Quite contrary to both perspectives, the true alternative for Cohn was either to accept, on the one hand, the exchanges along with the innate tension to speculation 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 Lestition, *ibid.*, p. 299). As we shall see below in sections 2 and 3, this conception of speculation is reproduced by Hilferding as well, influencing his viewpoint of 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, p. 167). In this sense, the real dilemma is not between different regulated forms of capitalism but between capitalism and socialism.

However one appraises the final outcome of Hilferding’s analysis, his intention to incorporate the futures market in his general approach and analyze 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 realized the importance of commodity exchanges (derivatives) in the organization 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 as a fraction of the capitalist class. In section 4, we shall see how he associates derivative 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 the 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, p. 151). To use contemporary terminology, the model of the market that Hilferding had in mind was that of a standardized futures contracts on tangible commodities wherein contracts are held until maturity (*ibid.*, p. 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 20th 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.*, p. 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 is really close to the stock exchange procedures. 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.*, p. 152); while, second, during this time period there can occur unexpected price fluctuations beyond the control of any business (*ibid.*, p. 152-3). In this regard, the great benefit from futures markets is that there exists now 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, pp. 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 protected against unexpected price fluctuations in both their means of production and their final product. Hence, they can better control the production and realization 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 realization of profits (ibid., p. 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., p. 158). This ‘insurance’ reserve fund should be considered as part “of the necessary circulation capital” (ibid.). The existence of futures markets set free this part of circulating capital, allowing it to be invested in some other productive activity.

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., p. 158). In other words, the capitalist gets protection for free, which is not what

actually takes place. Let's 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. 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 ('sell') the risk. However, according to Hilferding, she ends up receiving the 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 total 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 use. As a result, less profit is earned on the same amount of capital, and the capitalist faces a reduction in her total portfolio 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 standardized 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 stabilizes 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 the derivative markets. But this was rather a general problem. While the organized derivative exchanges along with sophisticated financial strategies were fully established at the beginning of the 20th century,⁸ the development of financial theory was relatively poor even in the 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). Fisher's writings on financial theory accounted only for a 'slow' real progress on the field. They only dealt with elementary issues and did not attract any serious attention before 1930s.⁹ The theoretical production at the beginning of the 20th century is far behind the development of contemporary financial theory; the analysis of derivative markets did not attract the 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 organization of capitalism but also sees very well the general economic gains from the existence of futures markets along the lines of the 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' future spot prices. 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 risk. She cannot know the exact spot price in the future but the futures markets render that information redundant:¹⁰

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, p. 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 labor (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., p. 166). In this fashion, monopolistic combines can also be seen as *substitutes* to risk trading; their development “is eliminating the commodity exchanges” (ibid., p. 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 internationalized phase of capitalism.

3. Speculators and speculation: the innate spirit of capitalism

Quite the contrary from what one might have expected from him, Hilferding sees a positive role in the 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.¹¹

In Hilferding’s reasoning, speculation is synonym to 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, pp. 156, 154).

As we see, in Hilferding’s reasoning, the activity of speculation pertains to its own terms and patterns, always winding up to 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., p. 156). This process is associated with “a specific class of capitalists, the speculators, [...] who assume the burden of these price fluctuations” (ibid., p. 157). In Hilferding’s argument, speculators comprise a distinct fraction of the capitalist class that receive 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 without the participation of the ‘public’” (ibid., pp. 157, 158). This insight has three important consequences which will be analyzed in brief.

First, Hilferding believes that speculators bear all the market risk, leaving industrialists and merchants focused solely on their productive activities.¹² This is wrong because futures markets transfer risk from one party to another but they do not eliminate it (on the contrary, 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 derivative markets is that they commodify different types of risk, letting them being bought and sold by counterparties with opposite risk profiles and ‘appetites’.

Second, Hilferding has linked the existence of speculators (as 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 the 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., p. 159). Hilferding does not analyze 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 the economic benefits of them underestimating the instability that they might cause. He seems firmly convinced of the stabilized role of speculation.

Hilferding’s point with regard to speculators derives from this general outlook of speculation in capitalism. In fact, he apprehends speculation as completely *rational* economic behaviour on the ground 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, pp. 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.¹³ 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 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 fraction of the capitalist class.

This conclusion is in accordance with Hilferding’s general view of finance capital. In brief, finance capital is the 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, finance capital is fictitious capital when the latter is, to significant extent, taken over by the banking system, leading open markets to fade away (ibid., p. 149, 225). This amounts to a particular form of institutional organization 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 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 this portfolio aim at higher values and this must not be considered as a divergence from the true spirit of capitalism, but as the latter’s very essence. Hilferding indeed wrote a whole book to explain how this new financial development is linked to the organization 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 in the financial markets must not be taken for granted: they do not pertain to the social nature of the capital relation.¹⁴ Setting that aside, his intervention is indeed ingenious because it invites a new way to think of capitalism: *as an exploitation system that is associated with an active portfolio management process*. This is the real question involved in the project of finance capital. If the 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.

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

So far we have analyzed 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 of 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, p. 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., p. 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 realizes that given the liquidity of futures markets, derivatives can easily become interest bearing securities attracting capital of banks from

alternative interest-bearing investments (*ibid.*, p. 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 stabilizes the trend of the prices to the benefit of industrial capitalists.¹⁵

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.*, p. 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 exclusive 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 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.*, p. 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.*, p. 169). This expansion of the investment sphere for bank capital imposes the fictitious form upon commodity circulation as well.

Futures markets 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 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., p. 169).

In any case, the final result of bank's 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 futures market in the first place since price risk has to a significant extent disappeared (ibid., p. 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., p. 163). In this regard, monopoly capitalism undermines derivative markets. But, then, one could also argue the opposite: the rise of international competition brings derivative markets to 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 on Hilferding's argumentation. Regardless of the abovementioned shortcomings in his reasoning, he attempts to approach derivatives from a general perspective putting forward that they become *a new form of money*.¹⁶ I 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 to 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) tends to eliminate derivative markets. This is because monopolistic combines can be seen as particular institutional arrangements for dealing with risk in an internationalized economic environment (that of the beginning of the 20th century).¹⁷

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

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, p. 153; emphasis added).

How shall we understand the above passage? According to Hilferding, derivative 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, derivative 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 the value of the underlying commodity*. In this line of reasoning, derivatives become a new form of money.

Hilferding's point 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., p. 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 "short period of production as against the long circulation time resulting from continuous consumption" (ibid., p. 152). The establishment of derivatives markets reinstates the missing stability by inventing a new form of monetary expression 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 capitalist able to assess the value terms of production inflows (means of production and labor power) and outflows (final product) associated with the circuit of the individual capitalist enterprise $M-C-M'$ at every point of time and space. 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 the price risk. This opens up fertile ground to rethink recent financial developments. It parts with explanations that associate derivatives with irrational behavior and attempts at considering derivatives markets in structural terms. Hilferding realized quite early the economic significance of

derivative markets for the organization 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 emphasized. *Derivatives do make a difference; but as sui generis commodities and not as money.*¹⁸ 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 should be considered as forms of money because they would bear a price without trading something. Nevertheless, derivative markets do not eliminate risk. They commodify and trade it: risk is singled out of the underlying commodity, sliced up, parceled 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 organization of capitalism. In brief, derivatives markets are, to put it simply, organized 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 commensurable.¹⁹ The form of abstract risk is risk measured in value, that is to say, money. Abstract risk is a mediating factor enabling different concrete risks to become social.

Hilferding's reasoning in spite of the above mentioned contradictions and shortcomings invites a distinctive approach to the process of speculation and financial innovations. The former (speculation) is just 'the most legitimate offspring of the basic capitalist spirit', while the latter (derivatives) is best understood under the 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 its weaknesses, Hilferding's text conveys a strong message for the understanding of contemporary capitalism in the context of Marxian framework.

6. Conclusions

The analysis of the paper 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 its weaknesses, 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'. Therefore, three, he realizes 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 organizes the exploitation of labor. 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 seek for more value) is associated with the organization of the 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.

Notes

1. For instance, according to Wray (2011), Hilferding's approach has had some influence upon Minsky. At the same time, Schumpeter might have been inspired by Hilferding as well (Miliotis and Sotiropoulos, 2009).
2. See Markham (2002a, pp. 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, pp. 44-5).
3. Undoubtedly there are many possible explanations, but these issues fall beyond the scope of this paper.
4. See Markham (2002a, pp. 267-9), Markham (2002b, pp. 93-4), Allen (2001, pp. 40-55), Steinherr (2000).
5. For instance see Weber (2000). At the same time, in paper published in 1880, Engels mentioned: "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, p. 280).
6. There is no reason to make the rather costly and inconvenient delivery. Both counterparties net out their positions, realizing 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, p. 105).
7. Hilferding 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 the process of production,

that is, a *pro tanto* (proportional) deduction from the profit which would otherwise accrue to industrialists” (Hilferding, 1981, p. 170). This is the dominant reading of Marx’s approach even in our days. Nevertheless, it must be stressed that there is also an alternative reading of Marx (for instance see Milios, Dimoulis, & Economakis, 2002; Heinrich, 2005).

8. See Markham (2002b), Obstfeld and Taylor (2004).
9. In brief, Fisher puts forward the “first formal equilibrium model of an economy with both intertemporal exchange and production” (Rubinstein, 2006, p. 55); and a rough version of the random walk hypothesis (Fox, 2009, p. 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.
10. This is the dominant contemporary argument (see Steinherr, 2000, pp. 100-102; Bryan and Raffert, 2006).
11. We 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, p. 134).
12. Once 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, p. 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., p. 159).
13. From 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 Weber, 2000, pp. 309-310; Lestition, 2000, p. 299).
14. For instance, see Milios and Sotiropoulos (2009).
15. We 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, p. 155).
16. Bryan and Rafferty have recently put forward in an influencing intervention 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, p. 133).

17. According to Hilferding there were other important causes for the establishment of the monopoly capitalism. Nevertheless, the existence of monopolistic combines obviated the need for risk management (see section 2 above). 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).
18. For this line of reasoning see Sotiropoulos, Milios, & Lapatsioras (2011).
19. For the issue of abstract risk see Sotiropoulos et al. (2011), LiPuma and Lee (2004). For an interesting perspective on derivatives see also Bryan, Martin, & Rafferty (2009), and Martin (2007).

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