

FICTITIOUS CAPITAL IS NO FICTION.

I was going to delay publishing data comparing the real to the fictitious multiple until profits for the fourth quarter of 2020 is released at the end of March. However, because of the debate generated by a recent Michael Roberts posting on *Covid and Fictitious Capital* I have decided to publish preliminary findings on this issue. [Covid and fictitious capital < Michael Roberts Blog < Reader — WordPress.com](#)

Fictitious capital causes a lot of confusion. If it was the case that the claims on surplus value, generally shares, bonds and mortgages, traded at their face value or what is the same thing, at the replacement cost of the assets they represent, the issue of fictitious capital would hardly arise, as there would be no market for these assets. There would be little incentive to trade them or speculate on them because there would be nothing to gain from doing so. The money you paid out would be the money you received back. These pieces of paper waiting to be clipped would lie gathering dust in the draws of mahogany desks. New York, London, Singapore and other centres of speculation would be mere provincial towns.

However, concretely, the market price for these claims do deviate, often sharply and abruptly from their face value. There are many reasons for this to happen most of which is stirred up by the phasing of the business cycle. Suffice to say, because of these oscillations, the price of these claims tends to jump around forming a market by their movement. The mantra in these markets is volatility.

Below is a table describing the difference between the (actual) market value of assets and the (paper) market price of the claims based on these assets. All these figures are from the end of 2019. To put these figures in perspective, annual GDP was around \$21.7 trillion at the end of 2019.

Green marks asset values on the left of the table, and red marks fictitious capital on the right. A few markets are omitted on the right side of the table such as bank loans and trade finance as the secondary market for these instruments is marginal. I have also excluded the \$21 trillion market for government or treasury bonds as they represent a claim on taxation which is primarily personal, therefore only indirectly a claim on surplus value. The figure of \$46.811 trillion is the minimum figure not the maximum figure.

Nevertheless, it still was 55% bigger than the market value of assets on which these claims were based. Trillions in paper profits abound. That is why it is wrong for Anti-capital to put an equal sign between claims and assets. The difference between the two forms of capital is equal to annual adjusted GDP.

Table 1. (trillions of dollars)

Description	Amount	Description	Amount
Non-residential Fixed Assets	\$26.209	Market Cap Wilshire 5000	\$32.838
Inventories	\$2.025	Corporate Bonds o/s	\$6.434
Currency in circulation	\$2.0	Non-Residential Mortgages	\$2.900
		Derivatives open market value	\$4.639
totals	\$30.234	totals	\$46.811

(Sources: Wilshire 5000 [^W5000 40,325.70 -476.41 -1.17% : Wilshire 5000 Total Market Inde - Yahoo Finance](#) Fixed Assets BEA Table 4.1, Corporate Bonds FRED FL104122005.Q, mortgages FRED Table MDOTPNNRP, Derivatives [BIS Statistics Explorer: Table D5.1](#) (I have not allocated currency to currency only circulating solely in the USA.)

The reader must have noted I have included currency under assets. Accordingly, before we proceed, it is important to understand that the capitalist class splits into three sub-classes (setting aside pure landlordism as owners of land rather than buildings) arising out of the metabolism of capitalism. The first is the industrial capitalist (the producer), the second is the commercial capitalist (the trader) and the third is the financial capitalist (the money lender). This splitting of function is governed as in all matters by the averaging out of the rate of profit (Das Kapital Volume 3). If there is a higher rate of profit to be made in commerce rather than production, capital will gravitate towards commerce from industry thereby depressing the rate at the point of arrival and raising it at the point of departure.

In all three cases the three categories of capitalists utilise actual capital though its forms may differ. In the first case (the industrialist) it is the means to produce commodities and the unsold product emerging from these means. In the case of the commercial capitalist, it is commodities and the means to circulate them. Finally, in the case of the financier it is money and the premises to engage in money lending. At this point it is important to stress, that which is seldom mentioned, money as notes and coin is not fictitious capital. Only once it leaves the hand of the lender in the form of a loan or a bond, does the loan or bond instrument become potentially fictitious capital. Finally, it needs to be pointed out as well, that both the industrialist and the trader will be in possession of some of their own money.

Two forms of fictitious capital.

In the market for claims or fictitious capital, two buyers are present, those who desire an income, and those pure speculators who seek to only bet on the price movements of claims. Thus, we can divide the realm of fictitious capital in two - Tier 1 and Tier 2. Tier 1 are the owners of the claims that are directly tied to the revenue streams provided by surplus value, we think of shares (the largest category) bonds and mortgages. Tier 2 are the owners of instruments based on Tier 1 claims, and which seek to profit from the movement in the prices of these claims. Tier 2 instruments are not a claim on a specific flow of surplus value. They are pure leverage. Tier 1 remains much larger than Tier 2 and is less volatile.

Why does the price of claims vary? There are a number of reasons. Demand and supply for these claims change. One of the prime determinants is the change in the balance of demand and supply caused by the phasing of the business cycle. Or there are changes to the underlying stream of incomes, for example if corporate profits increase annually due to investment, a constant P/E ratio would imply that share prices are rising, or conversely, if interest rates on bonds fall then the price of these bonds rise. Or take exchange rates. This is one of the biggest areas of speculation globally. Changing trade balances, capital flows and the perception for the prospects of the economies of particular countries all go into the mix estimating exchange rates. Above all Tier 2 depends on the cheapness of money, or what is the same thing, the rate of interest. To quote Marx in Volume 3, Chapter 25 on Fictitious Capital, "cheap money is like free drink to the alcoholic or pork to the glutton".

Talking analogies, the one I like to use concerns a river and fisher(wo)men. The size of the river which represents the flow of value is set upstream in the headlands of production. The fish in the river represents surplus value. The fisher(wo)men do not directly determine the number of fish, though if the capitalists decide to only invest in fishing rods neglecting productive investment, then clearly the number of fish would decline in the future. To fish costs a permit with its entitlement to a specific number of fish. The permits here represent the claims on surplus value. The higher the demand for these permits, the higher their price, the more it will cost to catch the same number of fish. The yield drops.

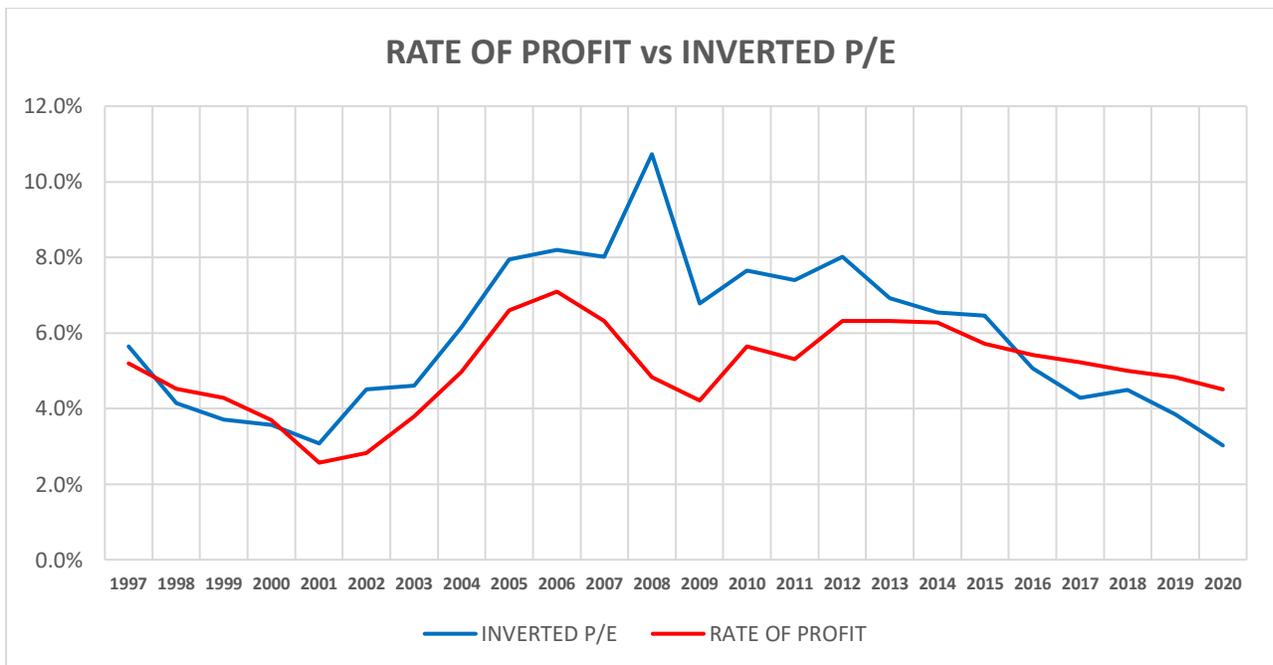
So, we have all these fisher(wo)men sitting alongside the river, elbowing each other for space in which to launch their fishing rods. They consider this work. Amongst them walks the pure speculators, Tier 2 speculators. Note, none of them have rods. Instead, their concern is to trade the price of existing claims using “derivatives” of these claims. By their very intervention they tend to drive up the price of these claims because some of those claims have to be held as security for their derivative trades, usually 10%.

The result of leverage or Tier 2 speculation is that the yield on claims tends to fall because their prices have been driven up. The more leverage, the more intense Tier 2 speculation, the lower the yield on claims. This loss is borne by Tier 1 investors such as pension funds, insurance companies, shareholders etc. Once again it is important to note, Tier 2 speculation based on derivatives does not generate its own income, it does not add to the mass of surplus value, rather it is parasitic diverting some of the revenue earned from Tier 1 to Tier 2. On a side note, it also explains why pension funds are in trouble as the yield on their investments have collapsed, due to a combination of the falling rate of profit reducing yields compounded by the activity of Tier 2 speculators further diminishing yield. Yes, your pension is diminished if you have one. The capitalist class, what a sight to behold, where individual clever leads to class stupid.

The data itself.

Marxist methodology is about the concrete. Anything else turns us into intellectual speculators. To determine the interaction of the movement of actual capital with that of fictitious capital I have derived a set of graphs. Graph 1 shows the normal rate of profit and the inverted P/E multiple which we may call the E/P multiple. In both cases profit is now the numerator. The same profit is used for both graphs and it is the unadjusted pre-tax non-financial corporate profit found in Table 1.14 (attached) line 43 in bold.

Graph 1.



The following methodology was used to deduce the mass of profits for the whole of 2020 in the absence of released profit figures for the fourth quarter. Profits for the first three quarters were added up. To this total I added a figure that is 5% below the fourth quarter in 2019 based on the most recent FactSet

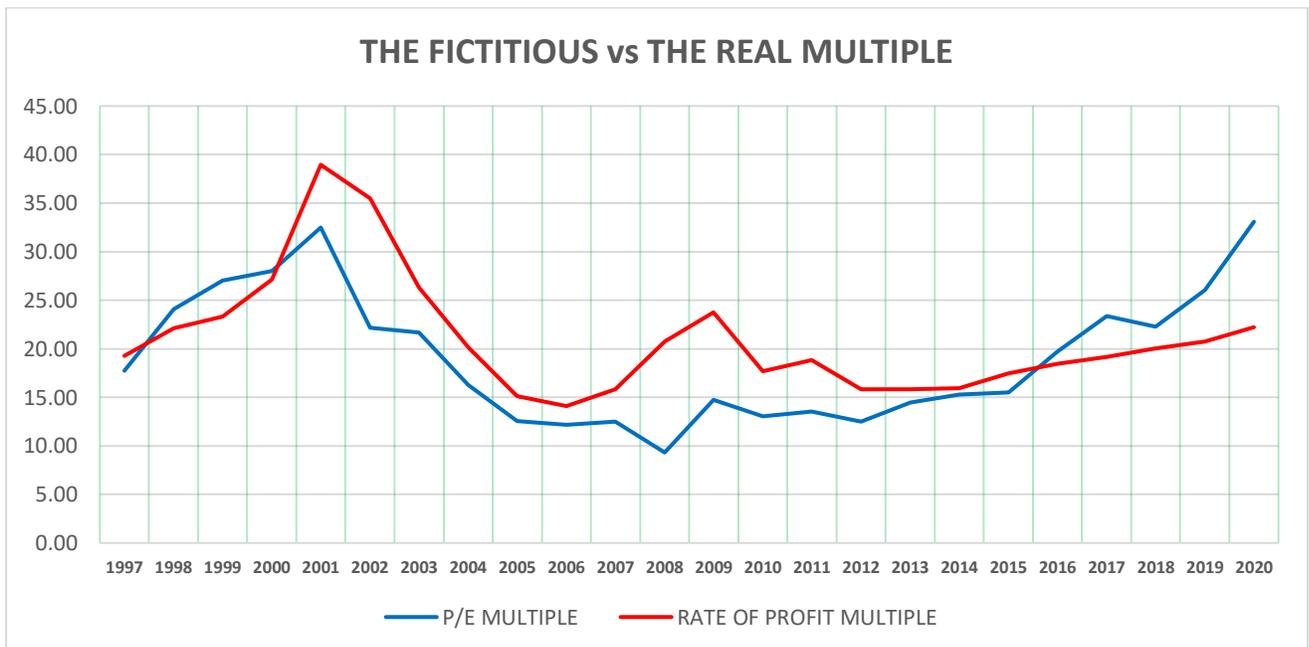
earnings release. I have not adjusted for the subsidies given to corporations amounting to nearly \$2.1 trillion during 2020 thus far and which have been used to inflate profits. Had I done so the rate of profit for 2020 would have fallen below the 2.6% level found in 2001 instead of the 4.5% registered in the graph. The good reason for not adjusting for subsidy is that without it, profitability in the US would have been so grotesque it would have collapsed the stock markets, and because it did not, and because these subsidised profits made the headlines, it was best to keep them in. If you want to read more on this largesse to those who least needed it, please read THE PRESIDENT WHO MADE "AMERICA BREAK" <https://theplanningmotivedotcom.files.wordpress.com/2020/12/breaking-america.pdf>

In terms of the denominator, the rate of profit is based on fixed and circulating capital. The data can be found in the accompanying spreadsheet. This is the most accurate formula for the actual living breathing rate of profit. Fixed capital for the fourth quarter is derived by extrapolating capital consumption or depreciation for the first three quarters. For circulating capital, a simple extrapolation is used. The denominator for the E/P ratio is the market cap of the Wilshire 5000 which embraces 97% of all listed public shares in the US. Included in this of course are all the large cap shares found in the S&P 500.

What is extraordinary is the slow unbroken and progressive 6-year swoon in profitability from 6.3% to a propped up 4.5%. 6 years is just short of an entire business cycle. This speaks to an absent recession, more on this later.

In the graph below ratios are replaced by multiples. The P/E ratio is set back on its feet. Real capital and Market Cap now become the numerator. This normal presentation of share prices tells investors or speculators how much they need to pay on average to capture \$1 of profit. NB, over the last 5 years the fictitious multiple has risen above the real multiple. It now stands 50% higher than the real multiple signifying bubble territory because the market price of shares far exceeds the assets they are based on.

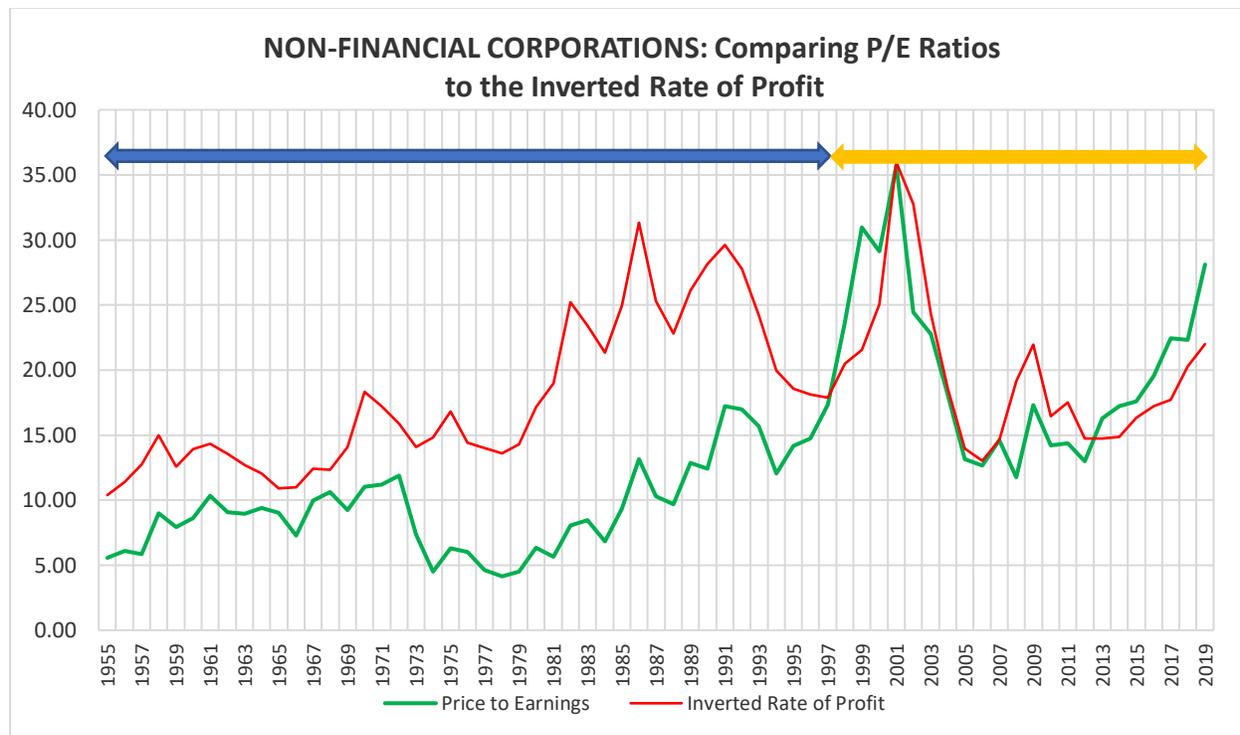
Graph 2.



(Note 1.)

This can better be seen over the longer term as presented by Graph 3, below. The ratios are slightly different because the profit data for it was taken prior to the downward revisions of profit by the BEA last year. Two periods can be distinguished. The first by the blue arrow and the second by the yellow arrow. The blue period is the healthy period. During that time, the rate of profit multiple (in red) exceeded the P/E ratio. This is as it should be because not all the profit announced can be withdrawn from businesses without jeopardising their liquidity. So, a higher rate of profit multiple incorporated this buffer. Market cap was therefore not divorced from yield.

Graph 3.



The yellow period is the unhealthy period. During most of this time the fictitious multiple has risen above the real multiple. First in the run up to the dotcom crash and in now over the last 5 years. Thomas Weiß in a comment on Michael Robert's blog postulated that the rising P/E ratio, being a multiple, was a surrogate for the falling rate of profit. This is not the case. In Graph 2 we can see both of them rising between 2001 and 2006 and between 2009 to 2014. They can also fall together especially after 2014.

In fact, prior to the recent central bank interference, oops interventions in the market, they shared a symbiotic relationship. Generally, a rising rate of profit, or at least the expectations of future rises was accompanied by a rising P/E ratio. Conversely, a plunging rate of profit collapsed the P/E multiple.

I rarely use Tobin's Q as a predictor. His idea is not a bad one, but his valuation of corporate assets is based on a tautology. He uses a discounted cash flow model to price assets; the higher the flow the greater the asset value, the lower the cash flow the lower the valuation, but what determines cash flow??? I prefer the CAPE Indexes. Like the CAPE index the P/E multiples used above are backward looking. Finally, the Buffett Index needs qualifying. If profit margins are 10% then the market cap of shares at 100% of GDP would not be no more problematic than a ratio of 200% were profit margins to rise to 20%.

The role of interest rates.

Michael Roberts is quite right to demonstrate in his blog that there is no mechanical connection between a fallen rate of profit and a financial emergency or recession. As the saying goes, it takes two to tango. It is one sided to look only on the side of profit. We need to look at interest rates as well. What provokes a recession is the scissors effect caused by a falling rate of profit together with a rising rate of interest. At the end of the industrial or business cycle, the period of turnover elongates. More credit is needed to maintain liquidity. Industrialists and traders go begging to their bankers. As bankers perceive increased risk, they charge a risk premium. Short term interest rates shoot up. A difficult situation turns critical, quantity into quality. A financial emergency looms.

This is what Marx meant when he said the chain of credit shatters. He was referring to the moment that credit seized up and only cash could be used to circulate commodities (Cash is King). Suppliers now demanded cash on delivery. It is not well known, but the biggest source of credit, in terms of its annual raising and extinguishing, is trade credit. Before it was possible to calculate circulating capital, that is up to 5 years ago when the turnover formula finally surfaced, the size of this form of credit could not be estimated. Thus, by its very magnitude any disturbances poses a challenge to capitalist reproduction.

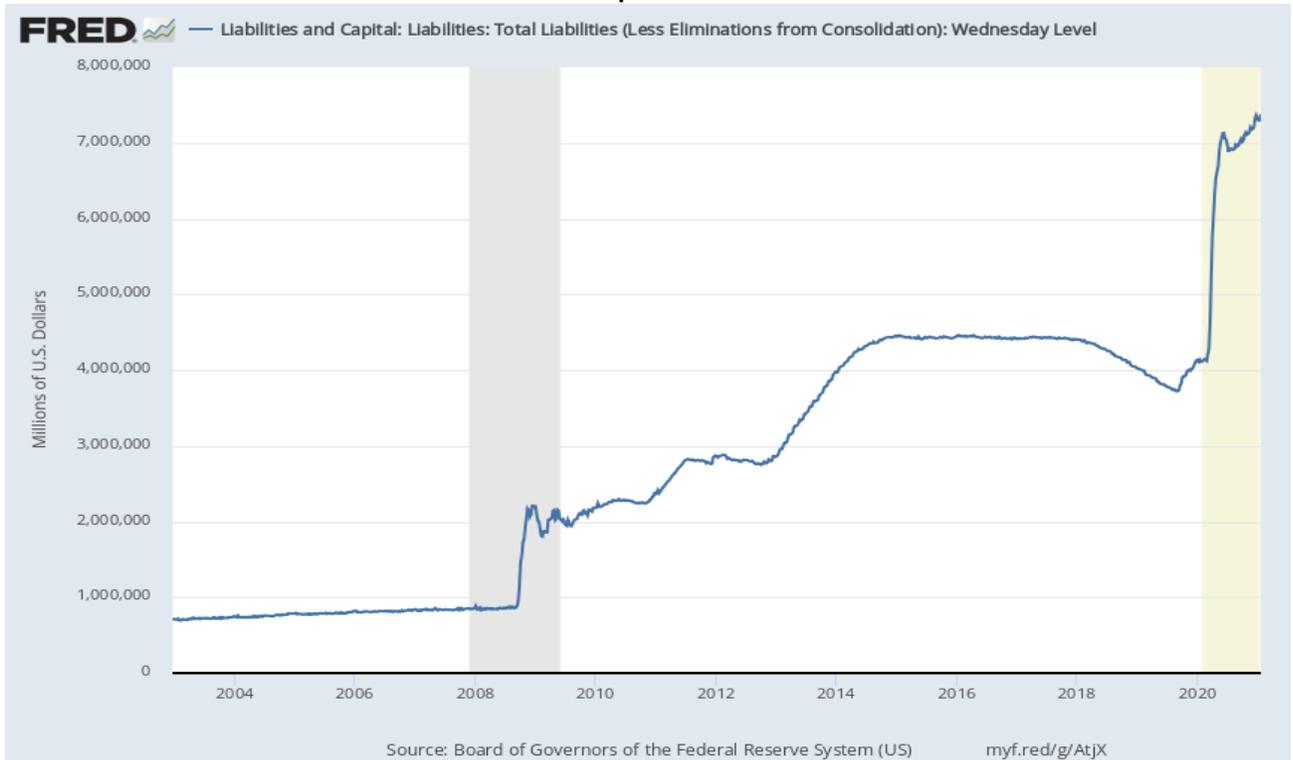
However, since the Financial Crash, central banks have kept a golden eagle eye on the movement of short-term interest rates, the ones associated with trade. They cannot do anything about the rate of profit, but they can do something about interest rates, suppress them. They have moved quickly and consistently to suppress any sudden rise in short term interest rates by increasing liquidity and improving access to that liquidity. Thus, the purging effect of interest rates has been neutered. This was particularly true at the end of 2015 when the global economy had an arrhythmia and the pacemakers kicked in. Blessed are the pacemakers. Of course, they saved the patient, but at the expense of multiplying the Zombies.

There is another side to interest rates, the rates that influence fixed investment, which are the long-term interest rates generally 7+ years. These rates, because they are longer dated, tend to be fixed, guaranteeing an agreed stream of income every year. Because their interest rates are fixed in an economy of shifting interest rates, they have become one of the central arenas for speculation.

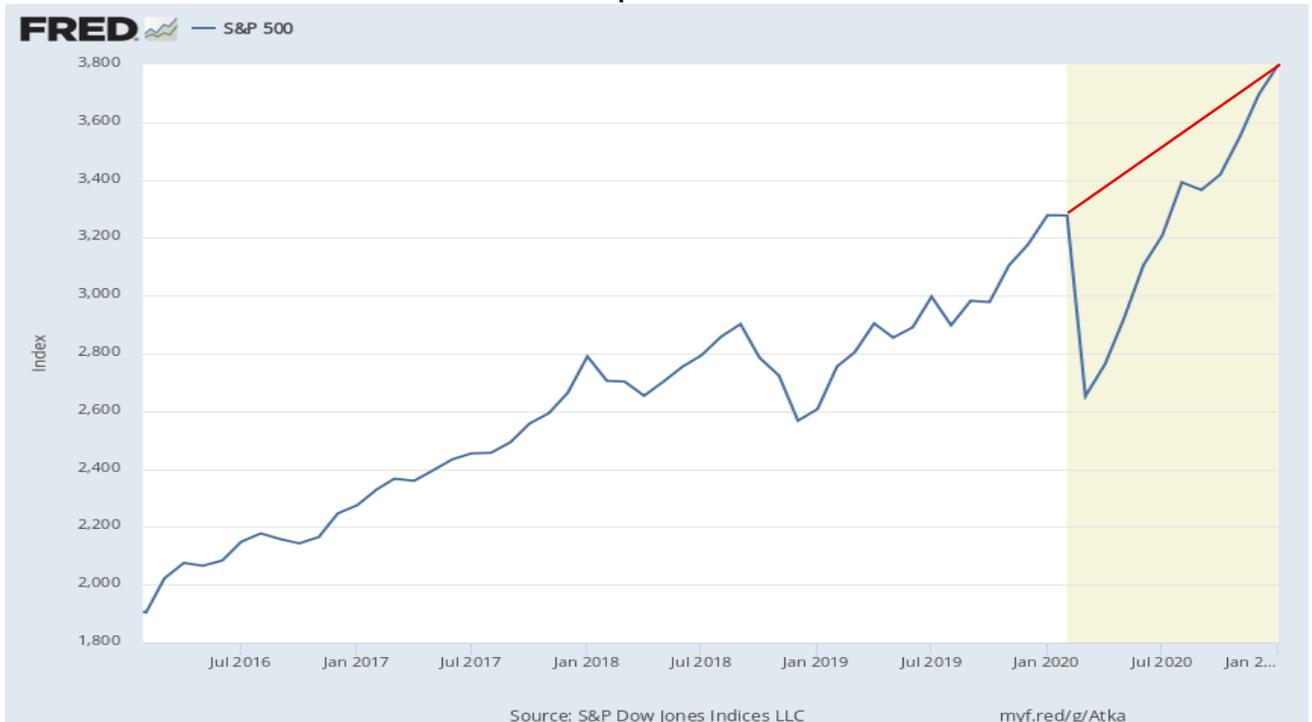
Central banks through QE focused their fire power on these bonds through large scale purchases. These purchases drove up the price of these bonds thereby depressing interest rates. The owners of these bonds made windfall profits and new borrowers enjoyed lower borrowing costs. As most of the owners of these bonds were richer investors, most of the cash and windfall profits went to the top 10% of society and most of it was used to speculate. The sums injected by central banks is staggering as the graph below shows. Seven Trillion Dollars by the FED alone since the financial crisis.

Of course, most of this liquidity was then channelled into speculation particularly in the stock market as shown in Graph 5.

Graph 4.



Graph 5.



The yellow bit signifies a recession. But look at the red line, it has risen this year despite the impact on the economy caused by the pandemic. That rise amounts to \$4.5 trillion dollars for the S&P 500. For the

Wilshire 5000 the figure rises to \$6.6 trillion. A nice earner. Seems the first vaccinations given during 2020, was the FED's vaccination of the share markets. No wonder US investment banks have had one of their best years despite the pandemic. They could not have reaped these rewards without the bi-directional volatility in fictitious capital markets caused by the pandemic and the FED's actions.

Of course, these are paper profits. If all these paper profits are cashed in at the same time, these paper profits will evaporate like a cloud on a hot day. The banks of the river would be littered with broken rods as everyone charges for the exit. But when only a portion of these winnings are cashed in at any one-time, fictitious capital markets are not disturbed and cash flows into the real economy where it increases the demand for goods and services particularly the luxury variety. If only 10% was cashed in during 2020, that would have added \$660 billion in extra demand. This was the intention all along behind the FED's largesse, not to trickle down to workers, but to bounce sideways between capitalists and their retinue.

The rich have got absolutely richer and the poor relatively poorer. It is for this reason that I have repeatedly pointed out how the top 10% of society now consume as much as the bottom 80%. This reality came to light when the Obama administration investigated the merits of a federal sales tax and the sources of this tax income. Without understanding the spending power of the top 10%, it is impossible to understand the US economy. This is an economy driven by the consumption of the top 10% whose spending habits are predicated on their capital gains. Goldman's research in 2010 was unequivocal. It took two years of consistent capital gains before the top 10%, and particular the top 1%, felt sufficiently confident to restart their spending binges.

For the moment, during the pandemic, we may have to revise this assumption somewhat. I refer to the millions of day traders who having been forced to stay at home, have been egged on by the likes of Reddit to use trading platforms like Robin Hood to speculate on shares helping to drive them up much to the chagrin and cost of professional traders. I wonder what is more real, the characters on their X boxes or the prices of shares on their laptops. In the end of course they will have their fingers burnt and have to pawn their X boxes. We should never support workers, for whatever reason, playing the stock market.

As long as cheap money abounds, the probability that share prices can be suspended between heaven and earth exists. And as long as it does, the economy can scrape by. But the opposite also holds true. Once capital gains turn into their opposite, the loss of capital, then the downturn will be much deeper. That is why the study of fictitious capital is so important.

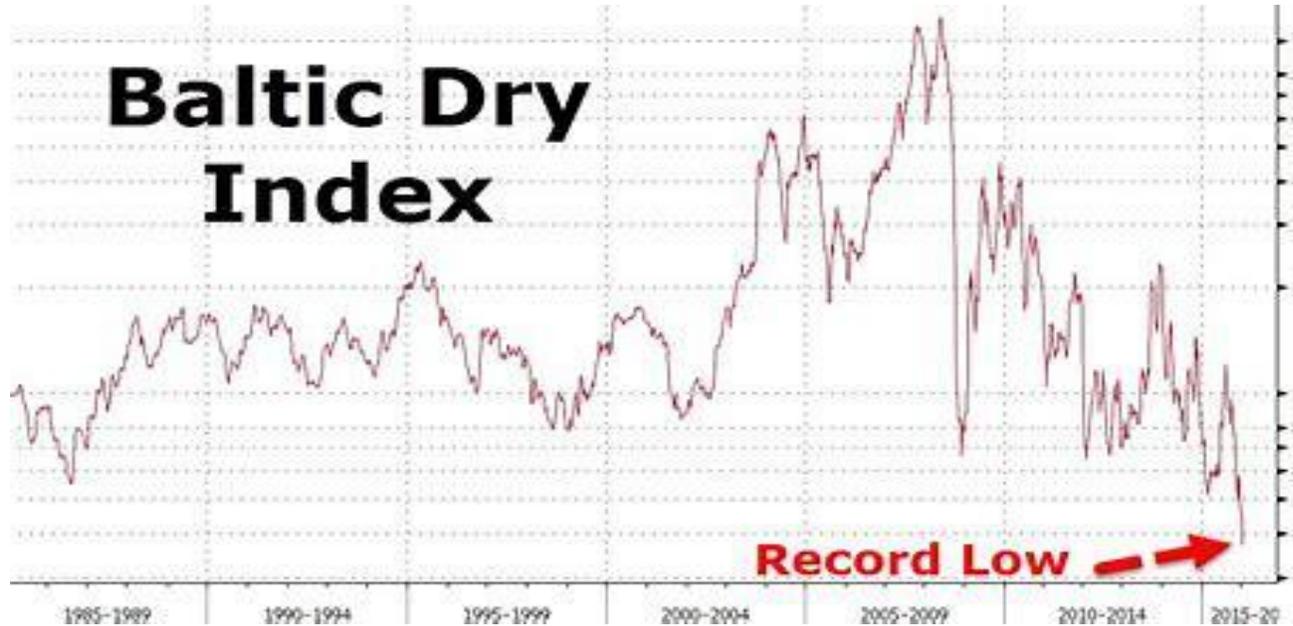
I will confess that I underestimated the impact of this flood of cheap money acting on fictitious capital and through capital gains, on the real economy. I expected the party to end at mid-night not sunrise.

Anti-capital could easily change his website to Anti-Fictitious-Capital as he considers them interchangeable.

In a recent article on his website [Current Fiction \(wordpress.com\)](https://www.currentfiction.com) Anti-capital graciously concedes that while Marx and Engels got fictitious capital poetically correct, they got it practically wrong. He uses the example of Maersk the world's biggest shipping line. I am glad he uses shipping as it is an industry most notorious for its ups and downs, for its booms and busts. At the beginning of the cycle there are too few ships and at the end too many because dammit ships take a couple of years to order and build. That is a long time in the life of a business cycle. Often just as the new ships are being filled with bunker fuel for the first time, markets collapse as the business cycles turns.

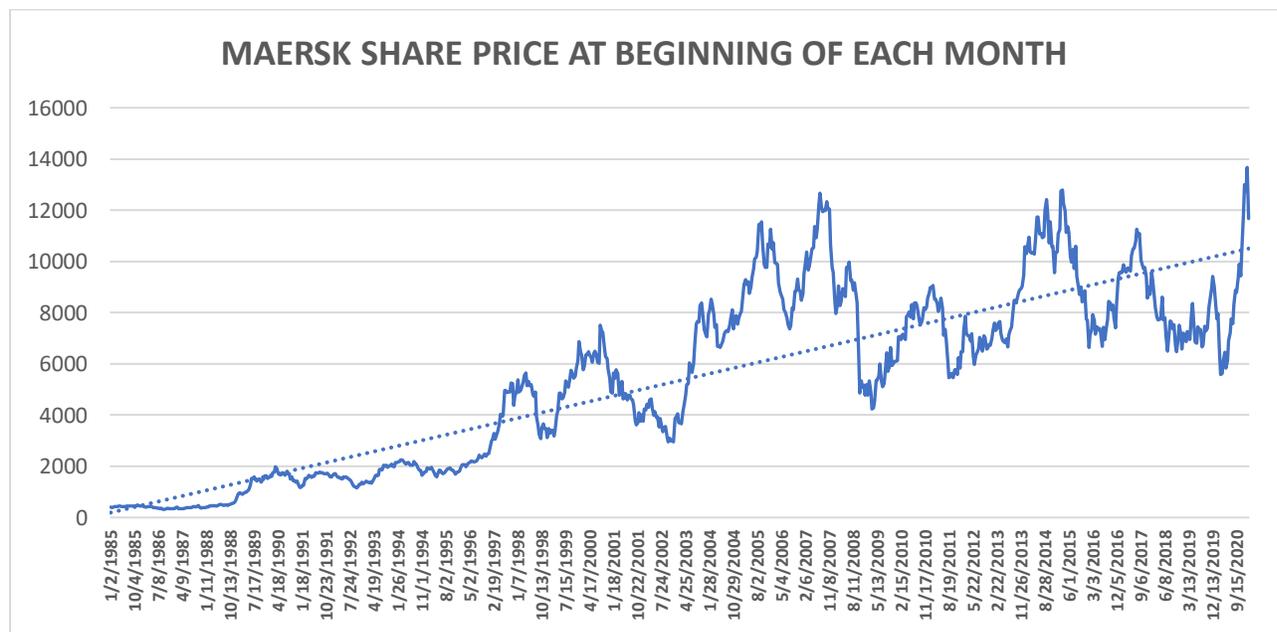
Below is the most famous shipping index of all, the Baltic Dry Index based in London. If the sea was this rough, then no ships would survive. 7 wild cycles since the mid-80s. Before moving on, yes, it is possible to speculate on the movement of the Baltic Dry Index itself. Is nothing sacred?

Graph 6.



Given the volatility of shipping rates, we can expect that Maersk's share prices will be just as volatile.

Graph 7.



[Share Information - A.P. Møller - Mærsk A/S \(maersk.com\)](https://www.maersk.com)

This volatility is enough to make shareholders and the Danish family who own it, seasick. But this is how they measure their wealth. Not by looking at the net asset value of their ships, shore assets and containers, but at the share price. During the upturn Maersk's share prices rise faster than the value of its ships despite the inflation in ship prices. During the downturn Maersk's share prices collapse faster than the market value of their ships despite the ships' price deflation. If investors in Maersk measured their wealth by net asset value during the upturn, they would be less rich, and if they measured their wealth this way during the downturn, they would be less poor. After 2008, Maersk's shares fell by two thirds. The price of second-hand ships less so. According to the following UNCTAD report, prices of five-year old ships fell between 27% and 47% depending on type (page 65). [rmt2009_en.pdf \(unctad.org\)](#)

The same applies to two adjoining homes. Both could be valued at the same price because their upkeep has been similar. But if one of the freeholders had just remortgaged at a much lower interest rate, while the freeholder next door is stuck with a more expensive mortgage, that freeholder will most definitely feel less well off. Fictitious capital touches us in many ways, often unexpected ways.

Sartesian poses the following question. *"What's the difference between the container ship owned by Maersk, and the corporate debt or loans, financing the construction and deployment of that container ship? Is one "real" because it's a physical object..."* The answer is not because they are physical but because ships and containers are products of labour. Before computerised share registries, share certificates were also physical pieces of paper, therefore products of labour, but here lies the difference, the labour expended on them was less than one millionth that expended on a ship, and yet, that share certificate could change hands at a price worth many ships.

True, ships are part of the specific social relation categorised as capital, as are its attendees, credit and debt. But the answer to that is, so what? It bears no significance. The real significance lies in this. Without these claims, titles or instruments, capitalism could not have developed. Finance could not have been raised because at their heart, these claims represent a socialisation of ownership, they represent the means to collectively own the means of production and the land. That is why they are exchangeable and therefore tradeable. That is why Marx devoted so much time to discussing the joint stock company without which large scale factory production would never have emerged, because the joint stock companies represented the pooling of individual capitals. That is why he coined the phrase "social capital".

While these claims represent the instruments of progress, they are also represent potential weapons of mass destruction; but that's capitalism for you. They are fascinating, and just as they make their own markets, so as subject, they create a distinct area of research.

The emergence of these claims together with their trade, has seen the emergence of large cities like New York, London, Singapore and Shanghai. Without them, these cities would be more provincial. Much of the trading done here is not due to the raising of new capital such as IPOs and new bonds. Most trading consists of trading existing claims or speculating on them. The film the Big Short showed how big the derivatives convention in Las Vegas had become prior to the Crash. Accordingly, when we view the majestic and opulent buildings which populate these cities, these palaces, we should see them for what they are, sky scraping tombstones standing over the mounds of wasted labour time, because capitalism has the unique ability to squander wealth in order to accumulate it. What to do with these buildings after the revolution? Should we turn them into giant museums where guided tours for workers can be arranged with the purpose of exposing how wasteful capitalism was at a time when hundreds of millions of workers were going hungry. Or are they simply too numerous for this purpose?

Conclusion.

I will conclude by looking at 2008. Fictitious capital may represent an independent field of enquiry, but fictitious capital is but the shadow cast by real events and developments within the world economy. 2008 cannot be understood without recourse to the structural changes to the world economy known as globalisation whose champion was the multi-nationals. Traditionally the major banks have had two kinds of customers, corporate and retail (consumer). Their prize customer has always been corporate. However, with the rise of the multi-nationals, global giants, part of their custom was lost. These large corporates generated their own liquidity, and if they needed more liquidity, they were big enough to bypass the banks and go direct to wholesale markets to sell their bonds.

In desperation, the banking system sought to replace them by expanding their retail base. They focused on pushing residential mortgages, consumer loans, car loans, student loans, credit cards. Traditionally, retail lending represented staid markets with few secondary markets. But as the mass of these loans grew, so the opportunity to dice and splice them grew, and with the emergence of these new instruments, grew the ability to speculate on them.

In particularly non-residential mortgages, thanks to the guarantees created by the Clinton administration, soared. According to FED data, outstanding mortgages rose to \$14.745 trillion at the beginning of 2008, overtaking GDP. In comparison US Public Debt amounted to only \$9.437 trillion. The film, The Big Short describes the frenzied speculation that surrounded mortgages especially the secondary leveraged markets betting on their prices.

True the rate of profit in the USA did begin to fall after 2006. But it did not end the business cycle because this was supported by the fictitious gains generated in amongst other markets, the mortgage market. The proof for this lies in the turnover of capital as I have shown numerous times. Turnovers only collapsed once the financial emergency broke out in the mortgage market, at which time the circulation of capital seized up, even to the point where the US government had to nationalise the car industry.

What 2008 showed us for the first time was this, a falling rate of profit can have a delayed effect on production when cashable gains are being made in the realm of fictitious capital. What 2008 also shows, is that when the fictitious capital markets finally collapse, the rebound on production is that much greater. 2008 was not a regular cyclical credit crunch as trade credit continued to flow up to 2008. In that sense 2008 was a pure financial event, representing a delay of two years between the fall in the rate of profit and this financial emergency.

Today, it has been 6 years since the rate of profit fell in 2014. This longevity is due to more alert central banks, who in 2015 prevented the pseudo recession from developing into a fully-fledged recession by intervening in the money markets to maintain liquidity. The cost of preventing the recession from taking its course has been enormous, the growth of unsupportable debt. Its bad enough skating on thin ice, but to keep adding to your weight, is never a sensible idea.

Note 1. It may be argued that the real multiple to be used should embrace the whole corporate sector, that is include financial corporations as well. I have modelled this, but it does not make much difference. Absolute values change slightly because the rate of profit is slightly higher in the financial sphere and therefore both multiples are lower. But relatively, the association between the fictitious and real multiples remains largely unaffected.

Brian Green, 29th January 2021.