

Financial Storm: The Mirage of Fictitious Economy and Paradox of Capital Expansion

Pinyue LU, Hui GUI¹

ABSTRACT After Great Depression of the 1930s, “government fiscal machine” has been applied in western countries to exploit new spreading space for capital. However, when Keynesianism proved frustrated in the 1970s, financial capital system in Western economy began to puff into a comparatively independent fictitious economic system with an aim of compensating for the malfunction of government fiscal machine. Since then, the radical feature that made contemporary economic entities differ from previous market economic entities came into shape, which was the structure that fictitious economy not only ran neck and neck with real economy, but dominated the latter. Their interactions composed the general pattern of modern economy, as well as held its moving direction. Therefore, the capital expansion paradox and economic crisis revealed by Marx changed its form accordingly. By exploring its new form of manifestation, hopefully we can figure out the essence of this ongoing crisis and explore an outlet. That is where utmost purpose of this paper lay.

1. Introduction

Where did the world-sweeping financial storm stem from? Mainstream economics, which based on “rational economic man” hypothesis, tries to attribute it to the greed of financial institutions and regulation default of American government. Thus, to them, the proper countermeasure is filling in the financing gaps by employing huge funds, so that financial system could resume sound operation in the near future, and then a strict supervision system would be gradually established over financial institutions. This “throwing good money after bad” idea sounds perfect, but it is unfeasible in the long run, for it just considered the phenomena, the government supervision failure, instead of the essence, the deep origin of why the failure happened. Therefore, their counter policy is kind of a temporary relief, and seems like a “putting the cart before the horse” policy in the long-term view. To find out the radical causes of this crisis, we have to turn to Marx.

Marx revealed the powerful dynamic function of capital. Unlike the way feudal society

¹ Pinyue Lu, Director and Professor of Research Center of Modern Economic Philosophy, Shanghai University of Finance and Economics, China. Expert of Central Government of China for Special Allowance.

Hui Gui , PhD student of Marxist Philosophy, Shanghai University of Finance and Economics, China.

reallocates surplus labor, in Capitalist society, human surplus labor is not consumed by social dignitaries, but transferred into surplus value via market operation, then gathered to plough into production system and made work as capital at an only aim of increment through expanded reproduction, which successfully brings forth lots of miracles in world economic evolution. “The bourgeoisie, during its rule of scarce one hundred years, has created more massive and more colossal productive forces than have all preceding generations together. What earlier century had even a presentiment that such productive forces slumbered in the lap of social labor?”¹ Although praised it, Marx pointed out the costs of capital’s great expansion dynamics, that is “capital expansion paradox” and economic crisis led by it. As capital indulges in pursuing self-expansion, there rest targets of two maximizations. One is surplus value maximization, the other is maximized surplus value transferred into capital. Under these goals, products overstock due to production’s exceeding consumption demands, then surplus capital and surplus labor force emerges, which worsens products’ overstocking embarrassment. This vicious circle results in economic crisis finally. Besides, there also goes with ecological crisis which rises costs of production factors and hampers expansion.

To relieve crisis, human society invented “government fiscal machine” and “fictitious economy” to exploit new spreading space for capital. Especially in the 1970s, after Keynesianism proved frustrated, financial capital system in Western economy began to puff into a comparatively independent fictitious economic system with hope of compensating for the malfunction of government fiscal machine. Since then, the radical feature that made modern economic entity differ from previous market economic entity came into shape, which was the structure that real economy not only ran neck and neck with fictitious economy, but was subject to the latter. Therefore, the capital expansion paradox and economic crisis revealed by Marx changed its form accordingly. By exploring this new performance form, hopefully we can figure out the essence of crisis and find an outlet, that is where purpose of this paper lay. As far as we concern, the irrepressible Capital expansion paradox is exactly the deep reason for financial crisis. Now, we will take a rough analysis into the whole thing and try to find a road out of crisis.

2. Failure of “Government fiscal machine” and Rise of Fictitious Economy

“Financial capital” remarked by Lenin and Hilferding refers to the combination of bank capital and industrial capital that belongs to “substantial economy”. On one hand, its capital logics behaves as strong dynamics for ceaseless outspread of substantial economy, on the other, the internal contradictions of capital itself display as expanding paradox, which result in

the crisis of substantial economy with Great Depression of 1929-1933 as a typical example. In order to ease the contraction, Capitalist countries absorbed certain socialist factors and adopted Keynesianism by applying government financial expenditure to produce public goods and enhance social welfare, so that part of the surplus value could be returned to laborers. To this extent, there is some progressive significance of Keynesianism. The multiplier effect after government investment tapped expansion space for capital, and inspired social economic development. On the other side of the coin, the augment of government fiscal deficit brought on decrease of investment from private capital, and their counteraction abated the effects of fiscal policy, which was so-called “Crowding-out Effect”². Economists always focus on the external phenomena of “Crowding-out Effect” (financial expansion leads to rise of interest rate, etc.), while neglecting the fact that these phenomena are the outcomes of capital expansion paradox working with “fiscal machines”: First, the enhanced fiscal expenditure is originally from raised tax income, and tax stems from surplus value divided by various property rights. Second, Launching public projects calls for huge number of production factors like land, steels, and coals, so the property rights of factors ask for much more surplus value shares, then the price of natural resource, means of production and monetary capital (interest rate) goes higher as a whole. Joint impacts of these two points make large part of industrial capital’s “original profit” split away, the net profit drop, and investment amount from industrial capital decrease. Here, a new form of capital expansion paradox emerges: the “Crowding-out Effect”, followed by a novel style of substantial economic crisis: inflation and stagnation, which indicates the fiscal machines’ malfunction once overstepping a critical point.

Thereupon, the neo-liberalism boomed, people tried to overcome economic crisis by market system itself and adjust function of capital by financial system. Financial system actually is the commercial system, which runs on surplus value in form of money and provides substantial economy with financing service. The radical dynamics for government fiscal machine is split shares of surplus value produced by substantial economy. There are two approaches for financial system to divide shares of surplus value: through substantial economy or through fictitious economy. If financial system only grasps intending surplus value by investing in substantial economy, and obtains it in the future, it still is an affiliation to substantial economy which far from being an comparatively dependent system. It could gradually separate from substantial economy and become an unattached fictitious economic system only after splitting surplus value shares through fictitious economy.

The idea of “fictitious economy” came down from Marx. According to his theory, capital in substantial economy split surplus value after production process took place. While the

financial products, say stocks, “are mere titles of ownership, which entitle the holder to a share in future surplus-value”³, the intending surplus value for them to split was uncertain and had not produced yet, thus it should be called “fictitious value”. The market value of stocks was fictitious value behaved as “monetary illusion” or “welfare mirage” instead of real money in substantial economy, thus stocks was a typical member of “fictitious capital”. For instance, supposing there issued a hundred million shares of one stock, if only some of them were exchanged at \$30 per share, the total market value of the stock was as high as 30 hundred million dollar, but if somebody exchanged at \$40 per share, its market value turned into 40 hundred million dollar immediately, which deviated far from value of the real assets behind the stock. Thus, “this value is regulated differently from that of the real capital, which the paper represents at least in part; or, when it represents mere claims on revenue and no capital, the claim on the same revenue is expressed in continually changing fictitious money-capital”⁴. There had been from the price of financial capital in fictitious economy to its value in substantial economy, and the deviation was subject to the social power structure in financial capital market.

As there was great uncertainty of financial assets’ fictitious value based on the expectation of future, speculations taking advantage of “uncertain expectation” emerged. Speculators tried to achieve value increment not via value creation in substantial economy, for in their eyes, what counted was not the price of financial assets’ itself, but to encash the difference of fluctuating price, that was the real welfare, the surplus value has been produced. Thus, speculative financial assets “are not real capital. They do not form constituent parts of capital, nor are they values in themselves”⁵. Then the “game of money proliferation” within financial system came into shape, and this was fictitious economy. Strictly speaking, fictitious economy was not “money proliferation”, for it never create any welfare, nor produce any labor value, but to “split money” by throwing money into fluctuating price difference of fictitious value, then encashed it to divide existing surplus value.

In Marx’s times, almost all of the social surplus value was hold in capitalists’ hands, the created surplus value demanded by speculative capital was in lack of abundant social sources. It thus could not grow into a huge fictitious economic system. Keynesian policies implemented after WWII required expansion of public consumption to ease depression, meanwhile, human capital in high-tech industry emerged, and working class fought for less stress, etc., as a result, wages in developed countries commonly raised, so that even common people was able to gain shares of surplus value by their “human capital”⁶. The capital expansion need to absorb these distributed surplus value back to financial system again, then the mass capital was shaped, it swarmed into financial system and enlarged it constantly,

which provided speculative financial capital with rich socialized currency source, then fictitious economic system came into beings with value capacity almost run neck and neck with substantial economy. In countries running on mature market economy, like Britain and US, the market value of stock market within native land were just about their GDP produced by substantial economic⁷. If adding the market value of real estates and financial derivatives into account, the total amount of fictitious economy would exceed GDP. Mass capital's emergence, however, couldn't be interpreted as "people capitalism" or "everybody has become a capitalist", for the only function of mass capital was to provide substantial economy and fictitious economy with "currency material". Then their "capital nature" lost, for their powers as "capital" was robbed by monopoly capital. Fortunately, mature capital market with socialist natures would be differ from this: it strengthen power of mass capital in capital market as far as possible; increase property income via investing in substantial economy; try best to avoid surplus value collected from mass being re-split by speculative capital power.

3. Manifestations of Capital Expansion Paradox in Fictitious Economy

As the reservoir of surplus capital, fictitious economy exploited and provided new space for capital and relieved paradox of capital expansion temporarily. But it still had been accumulating economic risks as energy for eruption of capital expansion paradox.

Fictitious economy supported by mass capital worked as accommodation of surplus capital and adjuster of substantial economy's money flow, it was able to ease capital expansion paradox in substantial economy and put off outburst of economic crisis. When calling for investment, substantial economy would draw on mass capital via financing, so that mass capital provided plentiful fund backup for economic development (especially for technological innovation) and impulse the price of financial assets increase. Then the welfare mirage, which caused by financial assets' fictitious value stimulated consumption, conduced investment growth and greatly expanded market capacity of social substantial economy. Hereby, developed capitalist countries, like US and Britain, got rid of stagnation and enjoyed prosperity as long as 20 years by government fiscal machine. In a word, the invisible hand of financial market was capable of inducting capital's circular flow between substantial economy and fictitious economy based on requirements of economic development, and regulating flux automatically, finally it succeeded in enhancing the elasticity of substantial economy's market capacity to a big extent, and postponed economic crisis.

As a great financial innovation in the 1970s, financial derivatives enlarged the function above to open more great space of capital expansion. They play the role of financial leverage: one could set up business contracts in huge amount of money with little deposit. (ratio

between the two was so-called leverage rate). Thus, financial capital's capability of dividing up the created surplus value by speculating the price difference between financial spots and its fictitious value was multiplied. Furthermore, financial derivatives diluted and imputed investing risks, so that further facilitating the capital expansion. For instance, substandard housing loans with high interest rate had used to be a high-risk financial business, for loaned money would fail to recoup funds as if the housing price fell. This kind of risk restricted the expanding space for real estate market and resulted in the depression of substantial economy. Whereas, these substandard loans were made up by investing banks into CDO bonds and issued openly. Not only rating companies entitled them high credit rating in order to receive high rewards, but also some funds ventured big risks to purchase them for huge returns, and they pledged the bought bonds to commercial banks at low interest rate so as to put much more currency into purchasing via leverage rate. Thus, the risks finally imputed to common people worldwide who bought the funds or deposited to commercial banks. Mass capital turned into the holder of investing ventures and people became the ultimate undertakers of such risks. In this way, financial risks were finely concealed. Substandard loans could then be sold boldly; housing investment and consumption was stimulated and kept growing; housing price went high and high. Such a vicious circle accelerated capital expansion space's maximization.

Anyway, no matter how much fictitious value government fiscal machine created to extend market's capacity, capital expansion paradox accumulated continuously instead of being eliminated. Monetary illusion in people's mind made by inflated financial capital's fictitious value attracted more and more surplus value flowed from substantial economy into fictitious economy, which conduced fictitious value mirage and listed on company financial statements as achievements, then stock price rose and rose, more and more people were allured to throw their surplus value into stock market, which made financial capital's fictitious value jumped higher. Aside capital, the talents served in research and development of substantial economy also flowed to fictitious economic institutions, and substantial economic productive forces were seriously weakened. Thereby, constant expansion of fictitious economy led to shrink of substantial economic institutions, and then further pushed capital and talents "crowd in" fictitious economy. Finally, bubbles of financial assets' fictitious value blew bigger and bigger.

These swelling bubbles were the reflection of substantial economy's capital expansion paradox in fictitious economic field. Under bubble economy, the actual surplus value created by substantial economy reduced promptly, but this situation was overshadowed by "welfare mirage" of fictitious economic value. Both substantial economic recession and

financial risks in fictitious economic kept on accumulating. Just like “heavy head standing on weak feet”, this capital pattern was quite fragile, for the ultimate impetus for fictitious economy attributed to division of surplus value created by substantial economy. Along with the constant weakening of substantial economy, surplus value for this division became more and more difficult to meet the amount that the rapidly swelling financial assets’ fictitious values call for. At this moment, as long as some amount of financial assets asked for encash their fictitious value into “real money” (i.e., the real surplus value), bubbles would break at once. As profit chain behind fictitious economy collapsed, financial system lost its liquidity due to dynamics failure, more and more “financial black-holes” emerged along capital chain, and finally, financial storm broke out. Since bubble of financial capital was the reflection of substantial economy’s capital expansion paradox in fictitious economic field, the broken bubbles would unfold capital expansion paradox concealed under it. Bad debts inside financial system caused by unsound financial chain of substantial economy and disabled it from normal financing. Besides, monopoly capital, who controlled government fiscal machine, divided real currency up from mass capital via encashing its financial assets’ fictitious value. Thus, surplus value scraped up by the masses was reallocated in a moment, which made them rapidly “re-impooverished”. So social consumption demands got depressed, products overstocked, which brought on surplus capital, then surplus labor force, products’ overstock situation worsened, here an odd circulation of economic contractions came into shape: economic crisis did not emerge with the form of Keynes’s stagnation, it visited the world in its original style. The economic crisis driven by capital expansion paradox eventually got back its true features along the historical path of double negation, and what it performed was exactly the contemporary capital logics.

Why did the crisis outbreak in US, and deeply affected rest of the world? Mainly due to the special position US standing in globalization system, especially the hegemony of US dollar. As world powers divided global surplus value in international capital market, foreign exchange market and international trade market, US dollar hegemony was the result of this contention pattern and it successfully lifted US to the focus point of global financial capital, and enabled it to grasp enough shares from global surplus value meeting its domestic capital expansion demands. In view of limited space hence this story would be told in another paper.

4. Facing Financial Storm: Strategies and Policies

As government fiscal machine used to take advantage of swelling fictitious economic system to promote liquidity and ease capital expansion paradox, fictitious economy kept on expanding while substantial economy shrinking. Surplus value required by fictitious value

went far beyond capacity of substantial economy, then financial storm occurred. Therefore, the basic strategy is to put surplus value into substantial economy so as to resume substantial economic strength. In order to produce more value and distract speculating desire of social capital, various monetary policies and financial policies should be adopted to give full play to investing function of social capital in social financial machine. Furthermore, diversified fiscal policies can be taken to make use of surplus value from whole society to enhance infrastructure contribution for substantial economy and advance its technological level, as well as accelerate changes of its developing mode. In a word, these policies are mainly aimed at conducting surplus value moving from fictitious economy into substantial economy, and finally overcome financial crisis by reinforcing substantial economy. Some developed countries, however, have not figured out this key point, they used to throw huge amount of money into fictitious economic field with hope of compensating financial black-holes, just like “putting mud statuaries into the sea”. The practices focused on phenomenon instead of essence and the methodology stemmed from western economic analytic paradigm would be proved fail in the future.

The deeper reason behind the processes above was the substantial economy’s capital expansion paradox, but we should not eliminate capital at once. In fact, all social economic formations based on modern productive force have to reorganize social surplus value for expanding reproduction. Whereas, it is necessary to regular capital power, bring it into track of public profits, so that surplus value split by various power can be back to laborers who created it. This maybe is the radical difference between socialist market economy and capitalist market economy, details are hereinafter.

First, on relationship between capital and labor. Surplus value divided by capital should return to laborers of whole society through various ways, e.g. use it improving living standards or cultivating human capability of workers of whole society to realize all-rounded development of human beings. Only in this way, surplus value is shifted into not only laborers’ human capital, social insurance and public welfare, but also social culture that serves laborers. Then, the deviation from price to value made by capital power will be eliminated, and the deviated value will be returned to laborers who created it.

Second, on relationship between human and nature. Surplus value (ground rent) grabbed by resource property rights (which based on politic or legal system) should be throw into reproduction of resource and environment, making it serve as payment for laborers who create labor value during these processes. Then price of resource and environment would be equal to the consumption amount of human labor during reproduction, which would eliminate the deviation from price to value, and Marx’s labor value theory would prove right again. The

reproduction of “resource and environment” here refers to not only rebuild and renew the resource and environment that has been consumed, but discover and innovate substitutes for nonrenewable resource and environment (e.g.: develop new energy, new material, etc.). Thus, It calls for establishing a new market price system that much more rigorous and all-sided to cover all resource use rights and even contamination discharge rights instead of abolishing price of resource and environment. Industrial structure of circular economy developed during this process would be a great change in the history of human productive forces and initiate a new age of ecological economy.

Third, on international economic relationship. It should require setting up new world monetary system, new global industrial structure and new international trade system, so as to enable the surplus value grabbed by international monopolizing groups back to national economy each. Nowadays, international capital makes use of all its advantages in market power system to grasp surplus value that produced by developing countries, which facilitates the unbalanced plate framework of global political and economic system. As a result, developing countries turn into scapegoats for international financial and economic crisis, then the world becomes more and more turbulent and unset. We will urge developed countries to shoulder their international obligation, give the surplus value they divided back to developing countries, and finally build up harmonious international order which in favor of all human beings’ development.

In short, in order to overcome the economic crisis, it is necessary to supervise and pilot capital power by social forces, which pursue the public profits only, reallocate social surplus value with an overall consideration and finally guide the deviation from price to value back to human developing tracks. This way of development would become the great contemporary continuation of Marx’s *Das Kapital*, as well as the radical strategy fighting financial storm and economic crisis.

Notes and References:

¹ Marx, Karl, 1995, “Manifesto of the Communist Party part 1”, *Anthology of Marx and Engels, volume 1*, Chinese edition, Beijing: People’s Press, 277.

² Parkin, Michael, 2003, *Economics (the fifth edition)*, translated by Liang Xiaomin, Beijing: Posts&Telecom Press, 536.

³ Marx, Karl, 2004, *Das Kapital*, Chinese edition, Beijing: People’s Press, 529.

⁴ Marx, Karl, 2004, *Das Kapital*, Chinese edition, Beijing: People’s Press, 532.

⁵ Marx, Karl, 2004, *Das Kapital*, Chinese edition, Beijing: People’s Press, 529.

⁶ This doesn’t imply that law of wage in *Das Kapital* has been outdated. Because just like any other rules, this law reveals a tendency of wage formation process: Capitalists always pursues the maximization of surplus value, instead of describing actual results. Real results can be caused by various factors and rules.

⁷ Sheng, Hua, Aug. 29, 2007, “Ideas on Stock Market Value Exceeds GDP”, *XinHua Daily*.