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## **Causes of World Financial Crisis and Historic Lesson from Destruction of Free-market Capitalism Discussion on New Changes of Modern Market Economic System**

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**Abstract:** In terms of Marxism view, the world financial crisis is the essential product of aggravation of basic contradiction of contemporary capitalism, caused by the exploitation system of contemporary capitalism itself. Temporary capitalist economic development has entered into a new era of modern market economic system where market regulation and state regulation (state intervention) work together and supplement each other. The modern market economic system with Chinese characteristics in 21<sup>st</sup> century is a state-regulated mechanism of sustainable modern market economic development. For this economy, it is guided by morality mechanism. Market basically regulates the resource

allocation. Government intervention and supervision predominantly regulates the development of economic society.

**Key words:** financial crisis, market regulation, state intervention, modern market economic system

When fictitious economy was enjoying speedy growth in America, many commercial financial institutions were immersed in the illusion, in hope of reproducing the economic boom in 1990s. In the name of financial innovation, they issued various interest products and promote financial credit to expand unboundedly by taking advantage of capital from securitization to lure more and more lenders into real estate market. As the coverage of securitization was getting bigger and profit getting higher, financial market was out of control, especially when problematical mortgage-backed securities entered financial market through various financial derivatives, and subsequently generated foams in the real estate market. Finally, it must bring about rupture in the whole financial chain, thus the financial crisis triggered with the burst of foams. Therefore, the fast development of subprime mortgage market and rapid expansion of financial derivatives in America as well as the increasingly-swelling foams are the flashpoint of current world financial crisis. In other words, the once-in-a-hundred-year financial tsunami is ascribed to the American subprime mortgage crisis, which is an uncontradictable fact.

When people reflect the cause and root, it is universally believed that the direct reasons are the American consumption pattern which leads to the overspending of financial credit, Wall Street's big appetite and the loose supervision of government on capital market. Driven by materialistic desire and encouraged by investment banks, American consumers entered real estate market one after another regardless of their reimbursement capacity, which resulted in rapid expansion of subprime mortgage market, universally excessive premature consumption, overdraw consumption, substantive foams in real estate market and fictitious prosperity. Consumerism's consumption pattern is closely connected with greedy elites from financial institutions. The core value and business substance of American enterprises is to maximize shareholder's profits and capital earnings. Wall Street, a finance empire governing 80% capital of the whole world, is even more so. "Financial gamblers" in Wall Street are dreaming of sudden wealth, in the hope of maximum profit by minimum investment. That is the deep root for the increasingly worsened subprime mortgage crisis. The Republican Administration executes hands-off management policy and slackens supervision on capital market, which makes unprecedented chance for the greedy adventurers in Wall Street and gets the crazy gamble popular in defiance of risks. Undoubtedly, American government and financial authority' lax supervision on financial market, slack monetary policy, lenient mortgage examination and approval process are direct and critical causes of the occurrence of today's financial crisis.

When analyzing the causes of world financial crisis, we shall not only consider the matter from the technical level. That is to say, we shall not only look for direct causes of the above-mentioned crisis from operational level. In terms of Marxism view, basic cause and deep root for the financial crisis shall be revealed by considering the objective laws of modern capitalist economy operation and basic economy system. The financial crisis is the essential product of aggravation of basic contradiction of contemporary capitalism, caused by the exploitation system of contemporary capitalism itself. The basic contradiction of contemporary capitalism is the contradiction between sociality of capitalistic production and private capitalist possession of product goods and product fruit. It is mainly manifested in the following two aspects: on the one hand, the free market operates in the way of capitalist economy, which inevitably conflicts with the fundamental demand of proportionate and coordinated growth of the national economy and gives rise to the increasingly desperate disproportionality of capitalist economic development. The facts indicate that serious disproportionality among production sectors is the major manifestation of capitalist economic crisis in 1930s. Since the condition for realizing aggregate social product had suffered from wreak havoc, the economic crisis was triggered due to overproduction. Moreover, serious imbalance between real economy and fictitious economy as well as the internal imbalance of the both were the major manifestation of capitalist economic in 2000s. According to the data from Bank of International Settlements, by the end of 2007, market value of global financial derivatives was worth USD681 trillion, half of which was contributed by America and the rest mainly by Europe. Annual production value of global financial derivatives was only worth USD50 trillion. The ratio was 1.36:1. This serious imbalance was mainly characterized by the uncontrollability and disproportionality of global fictitious economy. The fact that financial activities were out of control and financial field appeared disproportionality increasingly worsened the contradiction of overproduction. Since the condition for smooth operation of capitalist economy was wrecked, it inevitably triggered financial crisis and even entire economic crisis. On the other hand, fundamental contradiction of contemporary capitalism was characterized by the contradiction between the infinite expansion of capitalist economy and the relatively diminished effective demand of consumers. The capitalist economic crisis in 1990s was mainly manifested by the disjoint of buyer-seller relationship. The disjoint was common when there was no market for several important products of aggregate social products due to the poor purchasing power. Today in 21<sup>st</sup> century, the worsening contradiction between the shortage of effective demand in real economy and maximized expansion of fictitious economy inevitably caused the disjoint of credit relationship in fictitious economy and triggered financial crisis.

Unbounded market mechanism pursues maximum capital and profit which are possessed by minor capitalist and operation. It is the intrinsic drive for the aggravation of basic contradiction of contemporary capitalism and the root for desperate capitalist system

of free-market economy. The world financial crisis together with the economic crisis provoked by the American subprime mortgage crisis is just the basic representation of eventual destruction of capitalism of free-market economy. First, as American government has objected state interference in the economy for the past many years, the laissez-faire policies out of government supervision propel the free-market economy into dead ends. World financial crisis has deeply touched the American financial system and broken down the American ideology dominating for half a century—states laissez-faire policies. In order to tackle the world financial crisis and global macroeconomic challenge, new laissez-faire policies must be abandoned. Therefore, the capitalism of free-market economy is not effective and rational. Second, world financial crisis is the realistic manifestation that capitalism of free-market economy is on the road to destruction. Since American subprime mortgage crisis, some western intellectuals and market participants have reflected the drawback of American free-market economy and cried, “It was the *day* the *dream* of global *free-market* capitalism died”, “Our known capitalism is dying”. A French economist in his book published in 2005 predicted, “Capitalism is dying”. Third, when trapped in the financial crisis, American government is intervening in the market with a series of measures, which marks the end of *free-market* capitalism era as well as the beginning of modern market capitalism era featured by market orientation and government intervention. So we can say that the state’s macroeconomic control has become an essential characteristic of temporary capitalist economy operation. Temporary capitalist economic development has entered into a new era of modern market economic system where market regulation and state regulation (state intervention) work together and supplement each other. It is the fundamental reason for the end of neo-liberal economics. Therefore, those mainstream American economists who pursue market fundamentalism and fight against state intervention go against the historical trend and will end up with failure, which is a bitter historical lesson.

Economic development history of capitalist world indicates that Adam Smith’s free-market economic theory predominated the entire laissez-faire capitalism development stage from 18<sup>th</sup> century to 19<sup>th</sup> century. Capitalist economy achieved a balanced and harmonious development in the way of spontaneous market regulation. Although world financial crisis appeared at that time, economy automatically recovered and the crisis was eliminated through the self-adjusting market mechanism, achieving a new capitalist economic growth. It can be seen that capitalist economy started from Adam Smith-era and ended in 1920s was in an era when free-market economic system and its development were guided by an “invisible hand”. The world financial crisis and Great depression in 1929-1933 broke the myth of invincible capitalist market economic system. The emerging Keynes’s “visible hand” theory led to the abandonment of Adam Smith’s “invisible hand” theory. All capitalist countries strengthened the government macro-intervention in the economic social development. The government intervention (“visible hand”) replaced the

market orientation function (“invisible hand”). However, the government intervention didn’t work any more in 1970s. It can be seen that capitalist economy started from Keynes-era and ended in 1970s was in an era when modern market economic system and its development were guided by the “visible hand” (state macro-control). Since 1980s, West capitalist-developed countries like America actively carried out neo-liberal economic policies. It stressed freedom and “minimum government intervention”, which was the denial of Keynes’s “visible hand” theory. The temporary capitalist economy on a new basis returned to the free-market economic system governed by the “invisible hand”. Actually, during this period, governments took advantage of market orientation to obtain combined effect of “both hands”. However, America and other international organizations under its control vigorously advocated free-market economic system and policy to the utmost limit, which suffered from opposition from all over the world. It was the biggest failure in the historic records. High respect to the unbounded “free market” began collapse in the middle of 1990s. Today’s world financial crisis and global economic crisis as well as the joint rescue efforts of government all over the world presented the end of neo-liberalism. Free-market economic system governed by the “invisible hand” died in its bed. Temporary capitalist economy has entered into an era of modern state-macrocontrol market economic system and development. In such mode, market regulation and government intervention work together and supplement each other. It is not only just the objective laws and critical characteristic of temporary capitalist market economic operation and development, but also the basic characteristic of modern market economic system.

In 21<sup>st</sup> century, new situation and issues have emerged from the operation and development of modern market because of high socialization and globalization of modern economy and economic activities. Because some features of its system and mechanism get to transcend countries, nations, social politics and economic system, it has become a commonly significant issue. Today, no matter capitalist society or socialist society, the mode of modern market economic system where market regulation and government intervention work together and supplement each other is applicable to the modern market economic system. Because it is global and inevitable, so it is a common choice for modern market economic development of both developed countries and developing countries. Therefore, the fundamental differences between socialist market economy and capitalist market economy lie in the starting point, principle of collective ownership, mechanism structure and ultimate goal rather than the modern market economic system mechanism itself which is governed by “both hands” and state macro-control. Deng Xiaoping explicitly pointed out, “For plans or markets, which is more is not the fundamental differences between socialist market economy and capitalist market economy”. Planed economy is not equal to the socialism, and capitalism also needs plans. Market economy is not equal to capitalism, while socialism needs markets. Both plans and markets are economic means. It tells us that: market mechanism and state macro-control (government intervention and

supervision) are economic means (called “regulatory mechanism”), which are applicable to both socialism and capitalism. The means themselves fail to represent the nature of socialism or capitalism of modern market economy. When American government made great effort to rescue the market, western medias and public figures cried, “America has already got through the redline between capitalism and socialism”; They alleged that America are establishing a socialist market economy with American characteristics in the manner that China establishes a socialist market economy with Chinese characteristics. However, the above arguments are wrong because they only present the surface phenomenon, failing to reveal the inherent problem. Therefore, we believe that the fundamental difference between socialism and capitalism of modern market economy mainly lie in the following aspects:

First, different standing points. Temporary capitalist market economy is a system that meets the material demand of people and makes profits for capitalists by developing material productive forces for material wealth. In contrast, temporary socialist market economy is a system that meets the overall demand of people and lifts up benefits of the great majority of people by developing all productive forces for material, spiritual and ecological wealth.

Second, different foundations. Temporary capitalist market economy is founded on capitalist private ownership, while temporary socialist market economy is founded on public ownership of production means which acts as the mainstay. The latter unswervingly upholds the dominant position of socialist system of public ownership of production means, especially the dominant position and function of state-owned economy, which is the fundamental difference between socialist market economic system and capitalist market economic system.

Third, different mechanism structures. Temporary capitalist market economy is a two-mechanism structure mode that market mechanism and government intervention supplement each other. Temporary socialist market economy is a three-mechanism structure mode that market mechanism guided by morality mechanism and government intervention supplement each other. In this regard, there are some brief explanations. By looking at the operation and development of domestic and oversea economies, we get to know that unscrupulous and greedy enterprises and delinquent government bring about disasters to the people. San Lu infant milk powder incident and mine collapse incident in Sanxi province in 2008 are bitter lessons. Social and professional ethics, including ecological morality, have become key constraints for the healthy operation of modern market economy, which generally guarantee modern market economy to advance towards socialist orientation. Capitalist free-market economy is an “unmoral” economy. It is unmoral and predatory because development of material productive force is based on the sacrifices in the following three aspects: spiritual productive force, ecological productive force, and personal productive force. The sacrifice of personal productive force refers to the sacrifice of lives

and health. Only through the guide of morality mechanism can we overcome the drawback of market mechanism and get rid of the defect of government intervention to guarantee the scientific, harmonious and green development of socialist market economy. Therefore, socialist market economic system shall build up a “three-mechanism structure” where modern market economy is guided by morality mechanism, and market mechanism and government intervention and supervision work together and supplement each other.

Fourth, different ultimate goals. The development of contemporary capitalism market economy is to realize maximum capital and profit and guarantee the capitalists and operators’ utmost possession of the fruit of economic development. To achieve this ultimate goal, human and nature are two means. In contrast, the development of contemporary socialist market economy not only meets the needs of sustainable survival and comprehensive development of human, but also meets the needs of sustainable survival of creature exclusive of human and the healthy development of ecology system. Human and nature are the ultimate goals of the economic development. It is a fundamental indication to distinguish socialist market economic system and capitalist market economic system.

In summary, the modern market economic system with Chinese characteristics in 21<sup>st</sup> century is a state-regulated mechanism of sustainable modern market economic development. For this economy, it is guided by morality mechanism. Market basically regulates the resource allocation. Government intervention and supervision predominantly regulates the development of economic society. Essentially, it is a socialist market economic system with Chinese characteristics.

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