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On the International Financial Capital, Financial Derivative Instruments & the International Financial Crisis----Analysis on the Financial Derivative Instruments with the view of Marxism Political Economics

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Abstract: There are a series of changes in the fields of international financial which include the international monetary systems, the innovation of financial derivative instruments, the uninterrupted storms of international financial markets, and developing fast with the international financial institutes. The author points out that these situations have a lot to do with the financial derivative instruments(FDI), which have many characteristics, and their functions are dual—in another word, they look like a double edge sword.

The author thinks that the developed countries' great financial crocodiles which take the U·S·A as representative have playing main roles in the international FDI markets, they not only dominate the innovation and development of the FDI markets, but also expand and strengthen their financial hegemony. There are many countries which particularly developing countries and the new-flourishing countries having been involved in the whirlpool of the FDI that were regulate by the U·S·A.

This paper also points out the FDI are just only fictitious capital (or fictitious economy) were made further fictitious. Investing in the FDI markets, which are just only struggle and fry in the FDI markets. Now, the FDI markets become a very important systems for the world financial capitalism to expand further and seize sudden huge profits.

Key Words: International Financial Capital Financial Derivative Instruments
International Financial Crisis the Would Financial Capitalism Systems

The international financial crisis, which is still threatening world economy, has turned out to be the most serious world economic crisis in the last 80 years. In the last 30 years, many financial inventions have been booming up, including financial derivative instruments, financial derivative markets and financial agencies. In all kinds of international capital activities, international financial capital is always acting as a leader. To some extent, the system of capitalist world1 has been turned to the system financial capitalism. Meanwhile, modern financial derivative markets, which are representative of financial derivatives market, have already taken the place of traditional financial markets. Since the Asian financial crisis in 1997, international financial crisis has been regarded as the root

1 [USA]Emennul Woulesdain<The Modern World System>,New York Academic Press,1974,P.347.

and display of modern economic crisis.

.International Financial Derivative Markets and the System of Financial Capitalism

1. Great changes in modern international financial markets

In the last 30 years, many surprising changes and events have taken place one after another in international financial field, which can be concluded to four main aspects:

——Great changes in international monetary system.

The “Nixon Crisis” in August 1971 and demonetization of dollar led to the downfall of Bretton Woods System led by USA. Since the chaos of international monetary and financial markets was still going on, In fact, Jamaican System in 1976 was not a real system. Furthermore, with the rapid development of Japan, EU and regional cooperative economies, Japanese Yuan and Euro have been listed in the International Reserves. All these above helped to form a basic situation which is characterized by demonetization of gold, centralization of paper money, flexible exchange rates and diversity of International Reserves.

——Inventions of financial derivatives and their worldwide application.

To deal with the fluctuation exchange rates, reserve rates, stock indexes and bonds, the mechanism of futures has been introduced into financial field. For example, there are foreign exchange futures, foreign exchange options, stock index futures, national debt futures, reserve rate futures, hedge, exchanges and so on. All these instruments and their related markets are derivatives from the original financial markets. Most of them came into being in the late 1970s. In another word, they are created with the downfall of Bretton Woods System. Since the mid late 1990s, thanks to the worldwide usage of Internet, especially after the Internet bubble in the new century was pricked, USA authority spared no pain in promoting those financial derivatives to stimulate the economy. As a result, the increasingly thriving financial derivative market has been the first choice of international hot money. The scale of the financial derivative markets soon exceeded their original markets. From 1972 to 1987, the total amounts of financial derivative markets grew to 865 billion dollars from zero. From 1987 to 2002, it grew to 100000 billion dollars. From 2002 to 2007, the number reached 500000 billion dollars, which is 30 times of USA’s GDP, 10 times of world’s GDP.¹

——Storms occurred frequently in international financial market.

Financial crisis has become the typical cause of national economic crisis, regional economic crisis and world economic crisis. For example, from the mid 1980s to the late

¹ [USA]William Bonner and Lila Rajia《Mobs ,Messiahs, and Markets》,Chinese edition, the China Citic Press, 2009,P.40.

1990s, Mexico economic crisis, Russia financial crisis, Brazil financial crisis, Argentina financial crisis and Turkey financial crisis, etc. but they were still single national financial crisis in essence. However, the Asian financial storm from 1997 to 1998 was the first real regional international financial crisis. And the subprime crisis in 2007 in USA is the first worldwide financial—economic crisis.

—Companied with the development of international financial derivative markets, international financial agencies have also enjoyed rapid growth in scale and position.

Being helped with the financial market, especially the derivative market, and financial futures, option, hedge, credit swap, guarantee, trust and investment Consultation Company were unprecedented hot. All kinds of investment companies and fund companies were playing an active role in these markets. At the same time, many financial agencies were not devastated in the “Stock Disaster” in 1987 and Internet Bubble at all. However, they got rid of troubles for one and another time in the boom of financial invention. In 1999, along with the publication of new bank laws in USA, most financial banking corporations turned to be all-round. They have integrated many sectors, like credit, security investment, real property investment and financial derivatives. The borders between banks, investing corporations, funds companies and security companies have been eliminated. So those financial agencies thrived in virtual economic fields and expand themselves in a surprising speed. Thousands of companies’ total capital had reached up to more than 10 billion. Some of them even exceeded 1000 billion. The number of hedge funds alone had increased to 9757 in the first season in 2007 from 610 in 1990, in charging of more than 1600 billion dollars.¹

2.the specialty and role of financial derivative markets

Since the late 1970s, there were what was called the revolutionary changes in financial field, and those financial crises, storms tsunami have much to do with the financial derivative.

Financial derivative refers to those financial exchange products which comes from financial original products. In another word, they are engrafted from the basis of traditional financial products like reserve rate, exchange rate, stock index and bonds. For example, the engraftation of futures exchange system has given birth to a series of new financial products, like foreign futures and options, stock futures, index futures and options, exchange rate futures and options, national debt futures and options. New products can also be created by old exchange instruments, like hedge, reserve exchange, exchangeable bonds or stocks, monetary exchange and so on.

1 [USA]Marding oulf “The Change From the Management Capitalism to Financial Capitalism ”, 《The Economy Guide》 ,27,12,2007.

Financial derivatives have only a short history. Basically, they were created with the establishment of Jamaican System. In the mid 1970s, because of the downfall of Bretton Woods System and demonetization of gold, flexible exchange rates have been widely applied in many countries and region, which brings a lot of uncertainty to international financial field, including capital market and foreign exchange market. As a result, financial market becomes more risky. So it is an urgent need to learn how to analyze and apply prediction to avoid risk and reduce loss. Financial derivatives are thus created.

The foundation and development of financial derivative markets is quite different from original financial market. Their characters are unique in the following ways¹:

——**High leverage effects, or in another word is the multiplier of market expansion.** The trading objects in financial derivative markets are not financial products themselves, not to say their label. It is the derivatives or derivative trading instruments virtualized from original financial products that are being trade in the financial derivative markets. Without many real products, there are just only a little guarantees fee or trading fee that can afford standard unit contract whose value is many times of the real one. That's makes the trading amount of financial derivative markets extraordinarily huge.

——**Unyielding temptations.** Because of the huge trading amount of financial derivative markets, the time is limited, which brings high exchange rate. So as long as the prices have small fluctuation, there would be great profits or loss in a very short term.

——**High risks both for single and system.** There are many complicated factors which could lead to the fluctuation of the markets, such as the factors of financial derivative markets themselves, original financial markets and economic, political, diplomatic factors both from domestic and abroad also play an important role, and so on. Of course, speculation from international financial giants are more.

——**The trading are Purely on market quotations.** On one hand, most investors according to the market or stick to the cost or time limit to make profit while on the other hand, a little handful of giants with deep pockets take advantage of all possible ways to create an illusion for public to pour their money in. In this way, those giants can make a large profit from the booming markets. For example, from 2007 to 2008, the oil price was tripled.

——**Financial derivatives and its related market are two-edged sword, which means their function and role have both positive and negative sides.** From the possible sides, they can raise a lot of money in a very short time to open a new way of investment and thus stimulate the market. If decisions and operations were reasonable, profit rates could be high and the time investment period could be short. Thus many investors are keen about derivatives. They can be helpful to industry capital. Also they play an active role in

1 My paper: "Analysis on the Financial derivative markets and our Countermeasures", 《Theory Research》, Shanghai Administration Institute, 2, 1998.

raising the cost of other capital and shifting risks and avoid loss caused by uncertainties. Under certain conditions, they can also help to the foundation, increase and development of real economy. They make all kinds of monetary market and capital market international and global to absorb foreign money and capital. In this way, risks can be avoided and cost can be raised. Financial derivatives are closely related to original financial products in terms of many concepts and themes of the markets. So to some extent, the boom in derivative markets can also stimulate the original markets. For example, under certain circumstances, stock index futures can boost stock markets. Foreign exchange future markets can also play a positive role in promoting foreign exchange markets.

However, on the other hand, we cannot ignore the negative sides of the financial derivative markets. First of all, the lever effect and flexibility of the market can easily create an illusion of thriving market to mislead investors and predictors. In addition, financial derivative markets are speculation in essence. Bubble is unavoidable. Besides, it is highly possible that some countries or some regions will be tripped into the bubble because of the over-developed virtual economy. With spared money and a lot of industrious capital in society all being occupied, real economy will lack enough investments.

.Basic pattern and characters of current international derivative markets

1. Basic pattern of current international financial derivative markets .

Basic situation of current international financial derivative markets for the last 20 or 30 years could be concluded as following:

Firstly, developed capitalism giants, represented by USA, have played a main role in all kinds of financial derivative markets. Some investment banking corporations, security companies, insurance companies, banks, fund companies and entrust companies have hundreds of billions of dollars, which means they might be even richer than some countries. Many outstanding ones are very famous, like Bear Stearns Cos, [Lehman Brothers Holdings](#), [Goldman Sachs](#), Fannie Mae, Freddie Mac, International Insurance Corporation, Morgan Stanley, Merrill Lynch, *Quanta Fund* and so on. *Their cooperation with each other can produce a huge impact both at home and abroad. In domestic market, they can change the future of financial markets. Also the publication of national financial policy is also affected by them. And they still seem to be unstoppable in international financial market.*

Secondly, western developed countries, represented by USA, are in charge of the financial derivative markets. *They have the final say of the market. Those rules and further inventions are also made by them. From the creation of foreign exchange future market in Chicago in the early 1970s to many inventions of many American financial agencies in*

2005, all kinds of new things of financial creation came from western developed countries like USA. Let's take the subprime mortgage as an example, first American authority initiated to set a series of favorable policies. Then the expansion of credit and loose monetary policy were put into use to make room for subprime market. Meanwhile the conception and strategy of new liberalism were promoted. Besides, the rule of virtual economic bubble was also made. American SEC and FASB put forward the accountant standard of universal value, which aimed to record and evaluate the price according to the change of market. In this order, the traditional standard was eliminated to give way to the boom of virtual economy.

Thirdly, western developed countries, like USA, strengthen their dominance through financial derivative markets. Obviously, "dollar dynasty" was made with the set up by the Bretton Woods Systems with dollar as a core so that dollar, the national money of USA, was acting as global money. Many far-sighted and brave scholars have released their critique. Jon V Kofas advanced the concept: "the financial hegemony"¹; Charles P·Kingleberger advanced the theory of "the last international loan provider"², which was seen as the conclusion of dominance and leadership of the international monetary market. Robert Wade's idea was like hit the nail on the hit. He thought that Walt Street, Washington, and IMF as integrity are in charge of financial market³. British scholar Peter Gown revealed the strategic intention of USA unities and other main profit unities in the late cold war times in his book, Washington's global gambling. Those USA unities wanted to promote new liberalism to further dominate international financial market. The international monetary system was also international economic system, national economic strategy and potential weapon of politics. He called it "dollar ——Walt Street System", and he claimed that compared with old Bretton Woods System, "dollar ——Walt Street System" gave American authority and USA financial giants more power to lead the international financial and monetary markets⁴.

On the one hand, dollar is still at the core of global monetary markets, which means the national money of USA still acts as global money. On the other hand, financial giants, represented by Walt Street, are still the bosses of all kinds of financial derivative instruments and markets. By manipulating the flow of international fund, continuous inventing of derivative instruments in financial markets and stick, capital all over the world,

1 Jon V·Kofas, 《The Sword of Damocles :U.S Financial Hegemony in Colombia and Chile, 1950-1970 》,Westport, Conn: Praeger ,200

2 Charles P·Kindleberger 《Dominance and Leadership in the International Economy: Exploitation, Public Goods, and Free Riders》,International Studies Quarterly,1981,P242~254.

3 Robert Wade: The US Role in the Long Asian Crisis of 1990~2000. in Arvid John Lukauskas and Francisco L. Rivera-Baatz, eds., the Political Economy of the East Asian Crisis and Its Aftermath: Tigers in Distress, Northampton, MA: Edward Elgar Pub., 2001.P.226

4 [UK]Peter Gowan 《Washington's Gambling in Globe 》,Chinese edition,2003.

financial agencies and real economies are attracted to serve for “Dollar—Walt Street—Washington—IMF” to provide profits and talents for Walt Street and USA.

Fourthly, many countries, including developed countries, especially for a vast variety of developing countries are involved in the financial derivative markets led by USA no matter they want to or not. Consciously or unconsciously, they become the sheep while Walt Street giants act as shepherds. In financial derivative markets, this super casino, only those giants can make use of every advantage while others just enjoy just a little profit. However, when depression comes, they all shoulder responsibility and sometimes even those little sheep bear all.

2. The Characters of the Current International Financial Derivative Markets

Basically, financial derivatives are the further invention of virtual capital or virtual economy. In another word, they are highly fictitious capital and economy. So international derivative markets are actually market speculation of derivatives. More than 140 years ago, Karl Marx pointed out in 《On the Capital》, fictitious capital was just a certification of characters of income capitalization. According to his theory, “People is always calculate income which is regular and repeatedly according to the average reserve rate”¹. Credit relationship is the foundation of fictitious capital, especially the credit relationship of loan capital: ”It set up the conception about capital as an auto machine which can earn profit itself”². The operation and accumulation of fictitious capital are totally derivate from those of real economy. In that times, Marx come to an acute conclusion that in all kinds of capitalism countries, all those so-called self-growing capital work in this way. The accumulation of monetary capital does not mostly depend on the accumulation of production requirement, but the accumulation of market price requirement, which is also called the accumulation of fantasy capitalism value³. Relying on the profitable mode and expansion regime of fictitious capital, a lot of monetary capital has ability to multiple its scale and profits.

If we say that in Marx’s time, activities of fictitious monetary capital have, more or less, something to do with real capital and they are still under the restriction of operation and accumulation of real capital, but nowadays, after more than 160 years, as an important invention of financial creativity, financial derivative markets are totally separate from the its related original financial markets, no matter in operation or accumulation. For example, foreign exchange rate future has nothing to do with foreign exchange trade, nor does stock index futures with stock trading, national debt futures with national debt. So the

1 Karl Marx 《On the Capital》, Chinese edition, the People Press, 1975, Volume 3, P.528~529.

2 Karl Marx 《On the Capital》, Chinese edition, the People Press, 1975, Volume 3, P.528~529..

3 Karl Marx 《On the Capital》, Chinese edition, the People Press, 1975, Volume 3, P.531.

relationship between fictitious capital and real capital is scarce in terms of derivatives. In another word, financial derivative is further virtualized from fictitious capital or fictitious economy. Derivative markets are actually games for profits and speculation with trading amount of tens or hundreds of times of original markets. In a visualized saying, quantity situation of world economy and financial markets is like an inversion triangle. In the bottom, the smallest layer is the real property or real economy. The upper layer, which is also the bigger one, is products' trading and their related service. And then there are stocks, bonds, foreign exchanging and normal future markets. At the top, in the most upper layer, which also accounts for most percentage, is financial derivative markets.

In that time, Karl Marx thought that on one hand creation and development of credit give rise to capitalism markets, especially accelerate the accumulation of capital. However, on the other hand, credit system should also be blame for over production and economic crisis. According to Karl Marx, "Under the modern credit systems, businessmen are in charge a large part of total social monetary capital. So, they can purchase other things before their purchased things are finally sold. This is how fictitious demands should come into being."¹ In many people's eyes, it does not matter what do many stocks, bonds and financial certifications real mean, products or fashions² as long as they can represent the predictable profit.

. Analysis of the expansion and profit of international derivative markets and global financial capitalism

As we all know, after the 20th century, of all kinds of capital, financial capital is the most active one with its best expansion and earning ability, particularly their manipulation and impact on the whole social economy. As early as 1903, Paul Lafarge pointed out that on the basis of manipulating and exploring their own countries, a small handful of financial giants stretch their hands to the world. The five most famous financial corporations control various industrious corporations, financial companies and business corporations in the name of different companies to explore not only USA, but also the whole world³. Rudolf Hilferding made it clear in 1910 that when financial capital controlled industrious capital, it became monopoly⁴. Vladimir Ilich Lenin pointed out more clearly in 1916 that financial

1 Karl Marx 《On the Capital》 ,Chinese edition, the People Press,1975, Volume 3,P.466
2 Karl Marx 《On the Capital》 ,Chinese edition, the People Press,1975, Volume 3,P.458.
3 [Franch]Paul Lafarge 《Lafarge Selected works》 ,Chinese edition, the People Press,1985,P.215
4 [Austria]Rudolf Hilferding 《the Financial Capital》 , Chinese edition, the Business Press,1994, P.252

capital had been developed into powerful monopoly with the help of credit agencies¹.

In the nearest 20 or 30 years, developed capitalism countries, represented by USA, have made full use of modern technology and financial invention to build a system of financial capitalism world which is controlled by monopolized financial capital. They earn position and high percentage of profit in international financial markets, international trading markets, other economic fields and even in global political fields, just like fish in water. They are working in following ways:

Firstly, the way for the operation of monopolized financial capital is to hold the model of real economy and high-tech industry. Such giants in modern industry, logistics, trading, construction and service often use listed companies as their organization of capital. In this way, the credit and collection of money have inevitably important parts of production and operation. Monopolized capital not only controls real capital in holding its credit and loan capital, but is also very powerful in shaping other aspects, like customers, exports and imports. Financial giants can be seen in many important industries and high-tech corporations.

Secondly, the establishment of venture investment fund will take control and help the development of new technology industries. In western developed countries, like USA, venture investment companies are highly developed. Many rising industries, technologies, materials and high-tech industries are dependent to the help of venture capital investment. Those all kinds of venture investment funds are unexceptionally the owners of financial monopoly capital. It is through the development of burgeoning industries and high-tech industries that financial monopoly capital enjoys another booming.

Thirdly, continuous invention of financial original markets and set up of new markets, including set up new trading varieties or trading instruments, will provide new sources of capital and thus create market demands. Just take the housing mortgage in USA as an example, mortgage is given out according to the degree of house to enlarge subprime mortgage. Besides, those loans with relative worse credit are converted into bonds to derivate a new financial products to appeal to financial agencies and investment corporations. And those agencies and companies will sell the bonds to insurance companies and hedge funds by packing, division and recombination. In this way, though the total amount of subprime mortgage is only 15000 billion dollars, 19000 billions of mortgage supporting bonds were published on the basis of financial derivatives. Furthermore, guarantee certifications of 1000 billion dollars and CDS (*credit default swap*) of 10000 billions of dollars thus came into being. Through this kind of operation in financial derivative market, American subprime mortgage is zoomed out and highly virtualized into bubble.

1 [Russian]Vladimir Ilich Lenin《Lenin Selected works 》Chinese edition, the People Press, 1995, P.608.

Fourthly, in financial derivative markets, including traditional derivatives and new derivatives, fluctuations are often seen. Sometimes prices are driven up while sometimes they are blown down. After 2007, the price of original oil was on the rise to a historical top point. Then since the summer of 2008, the price has been laid down. Actually, from 1996 to 1998, Hong Kong's stock market and housing market also endure the same experience, liking riding on a roller coaster. According to the research report of the Bank for International Settlement(BIS) , the total value of global financial derivative markets have been increased from 100000 billion dollars in 2002 to 516000 billion dollars in the end of 2007, which equals to 11 times of global annual GDP, 48000 billion dollars¹.

Fifthly, through the systems of financial derivative markets, financial giants have expanded, penetrated, grew themselves into international financial markets. Based on the guidance of financial development, "Washington—IMF" system spares no pain in promoting the conception and strategy of new liberalism. Meanwhile, on one hand, risks of financial derivative market are shared all over the world in the development of real financial operation. While on the other hand, those giants absorb great profits worldwide, especially from developing countries and regions. Under the elaborate operation of "Walt Street—Washington—IMF" systems, all kinds of derivatives are introduced into the world one after another. Due to the unchanged leading position of dollar in international monetary markets, attraction of American financial markets and huge power of American financial giants, all most the whole world wants to buy dollar's financial product and its derivatives. So large amounts of money pour into USA all over the world, which actually support those giants for braver invention and speculation. In this way, a strange circle is thus formed in the structure of world economy and international finance. Just by printing money, USA can buy all they want, particularly for products and services. And that money American spends will go back to USA by purchasing American's financial product, especially derivatives. After this circle, that money is still the dispensable financial capital of those giants. That is so called "the Horrible Global Financial Balance". In this way, with the help of "Dollar—Walt Street—Washington—IMF" systems, American financial giants get endless money from world products and services to win high profits.

Sixthly, it is through financial derivative markets and operation of "Dollar—Walt Street—Washington—IMF" systems, those magnates have earned a lot of money worldwide while risks and loss are shifted and shared globally. Thus a double unbalanced mechanism of payoff and loss has been formed. The owners of monetary funds and capital in the world not only provide profits for those magnates, but also bear some of the risks or even the whole for those financial speculators. Even now, when the world is suffering from the severe financial crisis, still the world bears the loss. According to American scholars, in only 3 months, from September to November in 2008,

1 the 2008's report of the Bank for International Settlement(BIS).