

[CN] Jianqi WU & Lihua CHEN**Contact Information**

Address: President Room of Hebei University of Economics and Business, No. 47 Xuefu Road, Shijiazhuang, Hebei Telephone: 0311-87655503(office) 87665186(family)

Fax:

Mobile: 13832111057

Email Address: wujianqi126@126.com wjq@heuet.edu.cn

Zip code : 050061

Homepage:

Jianqi WU, professor and vice-president of Hebei University of Economics and Business, --has mainly area of research has been “Capital”, property right theory and other related topics. At the same time, his concern has been for academic standards and college theory. He published two papers in “Economic Research Journal” independently and taken charge of issues of the National Education Ministry “inter-provincial competitive study”. One paper, “Raising Problem During Tutoring, Obtaining Solutions in Scientific Research,” was once granted the First Prize of Excellent Teaching Achievement of Hebei Province; his textbook, “Economics,” was granted the Eminent Textbook Award. Professor Wu has received the Second Award of Excellent Achievement of Hebei Social Science three times independently, and his opinions have been reprinted, cited, commented, consulted, and copied by many times. “Hebei Daily” once reported the academic activities of Professor Wu under the title of "Wu Jianqi Phenomenon ".

False Needs and Financial Crisis

——A Marx Economics Analysis on International Financial Crisis

[CN] Jianqi WU Lihua CHEN

Abstract : The relative overproduction is the universal substance of the capitalism economic crisis. The substance of the financial crisis happening presently has not changed, only has some different appearances: it seems the need is surplus. In fact, the logic of the modern financial crisis is: The traditional economic crisis resulting from overproduction→the expanding of false needs→the modern crisis resulting from the surplus of false needs and the inadequacies of real demand. The way to eliminate the financial crisis is not “to rescue markets”; but “to govern markets” and “to rescue real economy”.

Rapidly spreading to real economy and other countries, the financial crisis in the United States seems to be suddenly bursting out of control. In fact, it is the performance of the inherent nature of American economy. It is the instantaneous outbreak of the internal crisis of long-term accumulation; it is only ignited by sub-prime mortgage crisis. The relative overproduction is the universal substance of the capitalism economic crisis. The substance of the financial crisis happening presently has not changed, only possess some different appearances. The overproduction of classical economic crisis is direct. Meanwhile the overproduction of modern economic crisis is indirect: it exists in the form of illusion of excess demands or needs. The transition from traditional to modern crises includes an intermediate link; it is the rapid expansion of false needs. The logic of the modern financial

crisis is: The traditional economic crisis resulting from overproduction → the expanding of false needs→the modern crisis resulting from the surplus of false needs and the inadequacy of real needs. The temporary way to eliminate the financial crisis seems “to rescue markets”. But from the perspective of Marxist Economics, “to rescue markets” can’t eliminate financial crisis, instead it might even fast make the real economy as a whole into the quagmire of the crisis. The policy options may not be “to rescue markets”. “To govern markets” and “to rescue real economy” may be good choices.

I.False needs: the key factor of the transition from classical to modern crisis

There are two different views about the reasons of the financial crisis in the United States. First, it is the "mainstream view", its analysis focus mainly on the technical and operational level. They think the sources leading the sub-prime mortgage crisis are nothing more than “Lack of supervision” “Policy failures” and “Underestimating the risk”. In other words, for the institutional framework of the capitalist world, the sources of sub-prime mortgage crisis aren’t endogenous, they are exogenous¹. For example, someone looked at “the structural deficiencies of capital markets” as the main source², someone thought “the real reason lies in the distortion prosperity of the sub-prime market”³, someone attributed it to the whole financial system of America⁴, etc. Secondly, it is the "non-mainstream view"; it focuses on the basic level of the capitalist economy system, combined with the new situation of modern economy of U.S., it analyzes the sources with the crisis theory of Marxism economics. These kinds of views all agreed to attribute the sources to capitalist mode of production. However, in summary on the specific reasons, someone thought it was “overdraft consumption”⁵, someone thought it was “assets intumescences’ consumption patterns”⁶, someone thought this current crisis came from “other sources”⁷, etc.

This paper thinks the economic crisis is endogenous in the capitalist economic system; the substance of economic crisis is still the relative overproduction. However, there are different new features from the classical form of crisis. The classical crisis directly performed as a typical of overproduction, while the modern crisis performs as an excess needs—in fact, it is excess of “false needs”.

1 Zhao lei, “To Reflect the Causes of U.S. Financial Crisis,” *Economic Perspectives*, 11(2008).

2 Xu yiguo, “Latest Progress in Financial Liberalization: Empirical Inference and Practical Common Understanding,” *Journal of Hebei University of Economics and Trade*, (3)2008.

3 Yang wenchao, “The Mechanism and Revelation of Sub-prime Crisis,” *Journal of Hebei University of Economics and Trade*, (3)2008.

4 Feng hongji, “The Financial Crisis of The United States Should Not Blamed to Bankers,” *Journal of Chinese Academy of Social Science*, December 25, 2008.

5 Zhao lei, “To Reflect the Causes of U.S. Financial Crisis,” *Economic Perspectives*, 11(2008)

6 Xu yisheng, Chen xiaochen, “The substance of the financial crisis: over-consumption in the United States and overproduction in China,” *China CBN*, September 22 2008.

7 Bai baoli, “The Causes and Results of Financial and Economic crisis,” *Economic Perspectives*, 12(2008).

The strong motivation of chasing profit inherently makes the capitalistic economy overproduce: the growth of needs capacity to pay can not keep up with the growth of production. Although the financial crisis began from sub-prime mortgage crisis in the West today has many new features, and it has not yet worsen to a whole economic crisis. Its underlying essential is still the relative surplus that Marx had pointed out. That is, the real needs determined by income is inadequate compared to the needs of economic growth. Because in the capitalist production, the surplus value is the only goal, wages are only the means that capitalists obtain surplus value from the employment of workers. The broad masses of laborers are the mainstay of the consumption, so it should also be the mainstay of the market demand. However capitalists pursued in production is the greatest possible supply (including the surplus value, belonging to the production goal) and smallest possible demand (reflecting the wages of workers, belonging to the means of surplus value realization). This in itself contains internal logic contradictions between the means of production and realization of the purpose. In normal condition, a total social product ($C + V + M$) should act not only on behalf of the volume of aggregate supply, but also on behalf of aggregate demand. In this condition, total social product can be sold, and the society can achieve the equilibrium of aggregate supply and aggregate demand. However, the capitalists are not concerned about balance, but imbalance. In the three constitute of the total product, the capitalists eagerly expand the surplus value M , while subtracting variable capital (wages) V . In fact, it's V that constitutes the revenue base of workers' effective demand. A relatively narrow V in total products means lower ability the consumers to pay, so the effective demand relatively decreases. Meanwhile, as capitalist class income M grows in the share of the social total products, their marginal propensity to consume will be lower than the workers' marginal propensity to consume. Compared with the growth of social total production, the effective demands of workers and capitalists are both reduced. So the final demand (need) will eventually lower, and overproduction is inevitable. The outbreak of the economic crisis is just a matter of time.

The capitalist class falls into dilemma: to extract profits as much as possible—that is to expand M and to subtract V . It will relatively reduce effective demand of workers and lead to overproduction. Finally, a crisis will break out, and the huge profits will be lost. This is not what the capitalists want to see. On the other hand, in order to avoid the damage of crisis, capitalists must increase workers' income to make them "affordable". But this means M will decrease. It is more than the capitalist class can accept. On the one hand, Capitalists are unwilling to pay more compensation to the workers to increase their income. On the other hand, they want to make the workers have "adequate purchasing power" that can buy all the social total products. In this condition, capitalists can realize the "thrilling jump" from commodity to money. They can get profit without paying any cost.

There are inherent logic contradictions in this strange naive idea. It is impossible to

realize theoretically. But capitalist is only the personification of capital. Individual capitalists' idea also embodied the inherent requirement of the capitalism mode of production. Individual capitalists can make use of the capitalist system to complete what they individual can not do: to make labors increase their purchasing power, without increasing their incomes correspondingly. This thing is incredible completed in such a way that the inadequate "real needs" must be offset by the additional "false needs".

There are two types of market demand: one type is the real needs, another one type is false needs. The real needs are the purchasing power determined by the people's actual income. The purchasing decisions are made after taking into account the actual income and real ability to pay. This type of needs is the factor to ensure the markets sustainability. But the "false needs" are not actual income-based. This type of purchasing decisions is not made by taking into account the actual income and real ability to pay. The "false needs" are beyond the actual income. It is only a "magical effect" after a variety of "innovative" activities to achieve. This "magical effect" can make the people who have no real capacity to pay feel they "have capacity to pay", so that the enough "(false) market demand" are generated. When the actual demand is insufficient, the economy will be in recession. For the prosperity of the market in the short term, some false needs can be created to make up for deficiencies of the actual needs. In such a market supported by false needs, capitalists needn't pay more wages to workers, and workers are able to have greater "purchasing power". In such a market, all the commodities can be changed into money, and capitalists can make more profits. Capitalist economy is bound to do such a satisfied thing.

The U.S. economy is essentially an economy where actual needs are shortage. So it has natural bond with false demand. On the one hand, false needs can absorb the excess supply to temporarily "alleviate" the contradictions of overproduction in some extent and to postpone the outbreak of the crisis. But on the other hand, each time to postpone the crisis is storage and accumulation of crisis factors; it is also a preparation for greater crisis. False needs accumulated over time. This leads too many and large bubbles in the economy. U.S. financial crisis is the results of bubbles bursting.

II. Forms to make false needs

The most typical feature of this financial crisis is that the false needs are too much. Capitalism economy is essentially an economy where the production is relative surplus and the real needs are inadequate. If capitalism is not as much as possible to suppress the wages of workers but do everything possible to increase the wages of workers, so that the laborers have sufficient purchasing power, that capitalism will not be capitalism. It is precisely because capitalism is not willing to increase the income of workers and provide consumers with a high enough capacity to pay, but also wants to sell surplus goods. They have to

"create" all kinds of false needs to sell their goods.

Commercial Credit: Credit and installment, which are early forms of promotion as well as a primary forms to make false needs. Because consumers' future revenues are overdrawn, the purchasing power of consumers is beyond the current income. The market demand is based on just psychological income expectations. This demand is constituted by the "real needs" (determined by real income) + "false needs" (determined by expected income). It "expands" the "demand". To a certain extent, it eased internal contradictions that the growth of actual needs can not keep up with the production, it has played a role to "rescue the markets" in early time, and it made the economy operate smoothly.

Bank credit: compared with commercial credit, bank credit is more modern and convenient; its scale is larger. Bank credit was originally created by adjusting the bank balance, because the different enterprises are at different stages of the capital cycle. Some enterprises had idle money; some enterprises were short of currency. These two types of enterprises achieve mutual benefit through intermediary banks, and the bank itself has earned a spread. Originally, the "swap" is only an adjustment that "who is going to spend the money," in circumstances of unchanged demand. When the quantity of money equals wealth of volume (considering the velocity of money and multiplier effect), false needs would not be produced. Moreover, the reserve requirements would not allow the bank to loan all money. The problem is that spread will encourage banks to lend as much as possible. The banks invented a variety of technological and systematic innovation. The result is that false needs are created.

Financial Innovation: Modern financial system is far beyond the traditional banking. "Financial innovation" played a complex role in the "fictitious economy" and financial crisis. Commercial credit and bank credit alleviated the contradiction of overproduction, but they can't eliminate this contradiction. This is determined by the capitalist production mode. With the further economic development, inadequate demand has become a big problem. To solve this problem, "financial innovation" came into being. "Financial Innovation" constantly renovated, the types of financial derivatives are numerous, having varied functions. But the most essential function is obvious, that is, to create false needs for the real economy. An illusion is made in which consumers think they have the ability to buy commodities.

Government regulation: A fiat is simply an order or decree; it does not have an intrinsic value. But it can buy any commodities, because government has decreed its dollars to be valid money. If the State issues much more fiat money in economy in order to make up the deficit, the false needs will be created in short term, and it will lead to inflation. Although Keynesian economics policy opposes (to) inflation, it conditionally agrees with the budget deficit policy, it puts forward "functional financial policy" and monetary policy to manage aggregate demand for employment. Because banks create money in a system of

fractional-reserve banking, the State can control the money supply indirectly. In general, there are three tools in its toolbox: open-market operations, reserve requirements, and the discount rate. The State can create false needs through creating money.

False prosperity: In the rising phase of capitalist reproduction cycle, commercial speculation and credit expansion may also lead to false purchasing power. False purchasing power can make capitalist markets prosperity temporarily. And this false prosperity can make the production and commercial scale far exceed the purchasing power of the actual social needs in a capitalist society. False purchasing power is bound to intensify the capitalist competition and anarchy of production, also to aggravate the vicious circle of social reproduction; thereby encouraging economic crisis appear frequently and continue to deepen¹.

All these channels can produce "false needs", making an even serious crisis. However, among the direct causes of the outbreak of the financial crisis in the United States, the role of "financial innovation" and the resulting "fictitious economy" are particularly eye-catching. The sub-prime mortgage is an important financial product of financial innovation. As other products of financial innovation, its aim is to create profit, marketing strategy is claimed to benefit the purchaser, and its design idea is to let the purchaser feel they have the future ability to pay. But the common result is that the false needs are created in society. At last it damages the overall economy. Many low-income families make purchasing decisions at stake their expected income of next few years or even decades, although their current real income can not support such a large purchase². This is typical of false needs. If many families look this non-existent false income as a basis to purchase, how large the risk can well be imagined. If there are large amount of such false income and false demand in society, the economic crisis is inevitable. From the sub-prime mortgage—one of the products of financial innovation, we can find that the modern finance is not based on economics; it has been captured by management. Financial innovation activities pay more attention to marketing idea, promotion strategy and so on as a "landmark event" in management. A harmful trap is hidden behind a tempting pie

With the financial innovation activities, asset securitization and fictitious economy followed. Stocks, bonds, portfolio of securities and a variety of financial derivatives including futures, options and so on are all fictitious assets. These so-called new products of financial innovation which are only fictitious assets, there aren't any actual trading good. For its own profits, the financial industry produced a pattern of constant renovation of financial products; this "financial innovation" accelerated the economy as a whole to be fictitious. The total value of U.S. financial assets accounted for the proportion of GDP has

1 Xu dixin, *The Dictionary of Political Economy (First Part)*, People Press, 1980.3.

2 Yang wenchao, "The Mechanism and Revelation of Sub-prime Crisis," *Journal of Hebei University of Economics and Trade*, (3)2008.

reached 205% in 1985, 11 years later, soared to 377.7 % in 1996. In 2006 the U.S. money supply is even more than its GDP to 6 times². "Hollowing out" process did not give the U.S. economy a solid base, but made it on a huge economic bubble. Any link in credit chain met trouble; there will be a series of response, the financial crisis will breakout.

The United States has a very well-developed financial system, for long so-called "financial innovation" has created false needs and economic bubbles, its fictitious economy has reached a super-high level. The breakout of financial crisis is only a matter of time. However, the U.S. financial crisis has been able to wait until now to outbreak, it was due to other sectors in real economy maintaining the huge U.S. financial industry, while the fictitious economy in the United States is relying on the real economy of other countries in the world. If there were no closely linked real economic and financial sectors in United States, if there were not integrations of real economy in the world and fictitious economy of the United States, the U.S. economy as a whole would have burst much early!

The main culprit of U.S. financial crisis is the U.S. financial industry. It is the U.S. financial industry that damaged the American economy as a whole. Therefore, in order to shake off the financial crisis, the United States should rescue the real economy, increase consumer income to expand the actual demand. Simply injecting money toward the financial industry to "rescue the markets" only can create a greater bubble of false needs. This way may make the U.S. financial crisis worse. The wise choice isn't "to rescue the markets", but "to rescue real economy" and "to govern markets". That is why, on one hand, to rescue the real economy and increase the income of workers to improve the actual demand, at the same time, to govern the financial industry, making "financial innovation" activities within proper framework, making fictitious assets "thinner" to adapt the real economy³.

III.On "right quantity" of false needs

The false needs are blamed for the financial crisis. So, are the false needs useless? Should any economic bubble be removed? In fact, since the human economy moved into market economy, the false needs and the economic bubble has existed with the "real economy". Use value and value are two factors of a commodity. The former is the material form of wealth. The latter is the value form of wealth. The contradiction of the two factors is inherent contradiction of a commodity. Although the use value is the material basis of the value, as the soul of a commodity, the value always wants to shake off the shackles of

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3 Wu jianqi, "How False Needs to Offset the Inadequacy of the Actual Needs", Journal of Chinese Academy of Social Science, December 25, 2008.

its material form to exist and move independently. In the early period of market economy, such trend to be "independent value" is very difficult to achieve. In the developed market economies, especially in western economy where the financial system is well developed, "independent value" has become a reality. Fictitious economy and assets were originated in the actual assets and the real economy, but also developed independently from actual assets and the real economy. With the scale increasing, the financial crisis from sub-prime mortgage crisis broke out in the United States.

Of course, it can be imagined, if there were no false needs or economic bubble in economy, if the scale of fictitious economy were equal to the scale of real economy, or in other words, if 1 dollar of goods corresponded to 1 dollar of money (if taking into account the multiplier effect and the velocity of money), if 1 dollar of market demand corresponded to 1 dollar current actual income, there would be no possibility of the credit and financial crisis.

However, a certain degree of false needs and the economic bubble are the lubricant of economic operation. Money supply in the economy has a powerful influence on the circulation of goods. When money supply is not enough, there will be too little demand (real or false). The economy will be depressed.

So it is ideal that there is a "right quantity" of false needs which can exceed the actual demand. This "excess" is no more to the extent of a crisis, but also can make circulation of goods smooth, and ensure the prosperity of the economy. In theory, this "excess quantity" is some "stagnation money" that is people's actual monetary income, but not used for actual purchase. It can be imagined, there are many "puddles" that can keep water on the economy "ground". People's some real incomes stay in the "puddles" and could not flow freely. Thereby, this part of real incomes can not become real needs of the market. At least there are four factors to form "puddles effect". The first factor is inadequate information about supply and demand. There may be a supply and demand of one commodity, but both sides don't know the information about each other. The second factor is inconvenient traffic. A commodity may not be traded due to traffic conditions. The third factor is the wealth structure does not match the structure of supply and demand, so that there are surplus of some commodities and shortage of other commodities. The fourth factor is some deposit. In order to offset this "puddles effect" of real income deposit, it is necessary to create false needs to fill "puddles", so that the real income can flow to form the real purchasing power, to guarantee the economy's normal operation.

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