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THE ESSENCE OF FICTITIOUS CAPITAL AND ITS ROLE IN THE DEVELOPMENT OF MOFERN ECONOMIC CRISIS

Abstract. *Authors analyze the term «fictitious capital» in this article and show its nature and main principles of functioning. Transformation of fictitious capital through the economic cycle and modern forms of fictitious capital are reviewed in the article. As a result authors make a conclusion that it is necessary to divide real and fictitious capital on all stages of economic planning.*
Keywords: *fictitious capital, real capital, economic cycle, crisis, speculation.*

Introduction

The world economy is in global recession and it is encountering various challenging systemic problems. These problems emerge worldwide: debt crises in Greece and Puerto-Rico, influencing USA and EU, a stock market collapse in China, a production downturn in Russia and Ukraine that is accelerating under the pressure of international sanctions. Centralization of the world capital accelerates during the global economic crisis, social stratification increases and a threat of a strongarm ways of problem solving rises.

Fictitious capital has a major role in capital centralization and redistribution of profits in favor of the richest people. K. Marx and F. Engels were the first to explore this phenomenon. This non-production form of capital is unable to create surplus value and has a tendency to grow uncontrolledly and then to impair during a crisis that allows big companies to centralize smaller capitals for a lower price than normal. Apart from that, fictitious capital can be used as a tool of inflation import and property seizure by the means of world stock market and currency intervention of countries with reserve currencies. In addition, there is a dangerous tendency to equalize different forms of capital (real and fictitious) in a public discourse that is not only false, but also harmful for economy. This confusion often leads to inappropriate ways of solving economic problems by politicians and managers. That is why nowadays exploring of fictitious capital (that is exaggerating rapidly and is causing an increase of macroeconomic instability) and its separation from real capital (that is providing global and national extended reproduction) is extremely urgent. The purpose of this article is to disclose the essence of fictitious capital, its functioning and ways to prevent its negative consequences to provide circumstances for sustainable growth of life quality.

1. Concept of fictitious capital

According to scientific definition [1] capital is production relations between a business owner and employees, when an owner carries all costs of labor and other factors of production to derive surplus value. Historically commodity and money capital are the first forms of capital. However, real capital becomes the main form of capital in capitalist society, it participates in production of commodities and surplus value, its turnover provides the basis for commodity and money capital. Fictitious capital does not belong to these types of capital. A credit certificate is its physical bearer.

We are going to analyze principal distinctions between fictitious and other forms of capital to reveal its essence. To start, fictitious capital is an agent of real capital, but it does not represent tangible property. This means that, generally, it could not appear without real capital and represents it on the stock market, but it is not related directly with means of production and other objects that it represents. It entitles its owner to receive income. Then, fictitious capital has something in common with loan capital (it allows to attract additional funds), but it does not exist as money capital and thus it does not participate in a production turnover.

In addition, fictitious capital does not create surplus value, it only entitles its owner to get a part of income and thus to redistribute it. It has no ability to create any product or surplus value. Its owner capitalizes revenue in a form of a dividend or interest, but that is only a part of income created by real capital.

Finally, fictitious capital turnover does not match with real and loan capital turnover emerging as a result of separation capital as ownership from capital as a function. Consequently in our interpretation fictitious capital is capital that has its own circulation different from real capital in its production and money forms and that is a tool of redistribution of income (generated for the period) or wealth (accumulated previously).

Fictitious capital as a stock emerged as a tool of increasing of entity's abilities to perform capital-intensive projects (construction of railways, canals, etc.), renovation and development of production. This allowed entities to centralize capitals both friendly and hostile. After an initial floatation (when capital at its nominal value acts as a real capital) circulation of these securities on the stock exchange becomes independent. Among the others bonds, promissionary notes, sales bills and other securities related to loan operations are attributed to fictitious capital. They all are titles of ownership, bringing profit to its owners in a form of an interest or a dividend. Accumulation of state bonds also relates to fictitious capital and means an increase in the number of the government creditors having a right to expropriate some money from the tax pool.

The circulation of titles of ownership (bonds, shares) creates an illusion that they form real capital. Nevertheless there price is not related to the price of real capital and changes depending on the size and the pledge of the future income. They become commodities with their own certain pricing mechanism and consequently with a freely fluctuating price.

As a result of fictitious capital evolution derivatives become its part as well as other securities. Derivatives add some new important abilities to fictitious capital: to hedge risks and to regulate the redistribution of the future income.

Nowadays they understand public capital as the aggregate of fictitious and real capital that confuses the principal distinction between them.

The increase of real capital is connected with the development of physical facilities to meet the growing public needs. At the same time an increase of fictitious capital reflecting in its market price is speculative, aiming not at the development of public production, but at maximization of their owner's income. In addition, public capital has almost endless potential to expand uncontrollably due to its fictitious part. Nevertheless, this expansion cannot be eternal, because only real capital provides a basis for all profits. An advance growth of fictitious capital (in comparison with real capital) leads to a fall in capital profitability in a whole and increasing instability in economy down to systematic crises. Moreover, fictitious capital's role and development changes significantly during different stages of economic cycle.

2. Fictitious and real capital during different stages of economic cycle

Public production is spontaneous due to the lack of coordination between production abilities and public needs. This randomness generates disproportionality of economic development: disparity of production in different sectors, of savings and consumption. As a result of chaotic actions of all subjects economic development becomes fluctuating, slumps change periods of growth such movement was called an economic cycle. K. Marx described movement dynamics of real and fictitious capital on different stages of economic cycle [1].

Finished products are sold slowly during the recession stage, so reproduction process ceases: equipment does not work effectively, there is an excess of inventories. Credit becomes called-for, so the interest rate rises. Unemployment grows due to the bankruptcy off small entities and layoffs on big ones, total production decreases. Capital owners consider ineffective to invest at this profit margin. Thus the basis of fictitious capital is destroyed: it has its own movement, nevertheless, it is closely connected with the real one. Fictitious capital decreases, the volume of speculative deals falls due to the poor market conjuncture. Market prices hit its bottom.

Business activity is extremely low on a zero stage of economic cycle (depression stage). Entities that realized a need to change their ordinary business schemes show first signs of revivng. This could be the search of the new market, equipment modernization for getting a competitive advantage, restructuring for a different function for a new market niche, implementing of a new production automatic control system (ACS) that increases management decision effectiveness. Real capital is the first to revive after crisis, so a recovery stage begins.

After such massive changes new growth sectors in economy emerge, where profit and employment increases; afterwards this process embraces the whole economy. After real capital recovery, fictitious capital starts to grow. Number of speculative deals rises, securities' turnover increases and business activity grows steadily. In a certain moment volume of fictitious capital exceeds real capital generating additional risks, provoking economic instability and market indicators fluctuation. During a prosperity stage, when real capital ceases its growth and production facilities have nearly reached its maximum output, fictitious capital has a potential for almost uncontrolled growth. Real investments that were prevalent at a recovery stage are replaced by financial and speculative due to its higher rate of return, entrepreneurs make more and more risky affairs sure un their success. Nevertheless, fictitious capital cannot grow infinitely, because only real capital generates basis to its existence.

As a result, of implementing of new technologies and management rationalization average costs fall, commodity supply increases its demand and causes overproduction. Development disproportion enlarge, overstocking emerges and inventory growth makes companies to decline production. A recession stage starts from this moment, production and real capital are reducing, total income falls cause of unemployment (for households) and profit margin decrease (for entities), so does the total expenditure as well. Fictitious capital has a certain independence and continues to increase despite the tendency of public capital development. A fictitious demand in an economy maintained by bank loans disguises overproduction and exceeds the solvent demand. An unemployment rate growth, fall of the level of income and expenditure in an economy, increase of costs and reducing of a profit margin lead to the situation, when crisis of disproportional development effects the circulation sector. An industrial crisis is accompanied with a credit and monetary crisis. While real capital brings less profit so do securities and, consequently, they lose their value. Market gamblers, whose purpose is to draw speculative profit, and broad public effected by stock exchange panic attempt to sell securities as soon as possible whatever the price to get some profit and minimize loss. Fictitious capital bubbles burst and market gamblers lose their money. The number of loan operations slumps, there is a chaos in an economy effected by bankruptcies of banks and insurance companies. Credit and monetary crisis in its turn aggravates industrial crisis, weak entities disappear from the market, and centralization of financial and industrial capital accelerates, when big companies acquire small ones that went bankrupt during the crisis.

To sum up, spontaneity of economic development determine its disproportionality and cyclicity. Fictitious capital increases following real capital and participates in distribution and redistribution of a surplus value generated by real capital. During a prosperity stage fictitious capital due to its potential to uncontrollable growth leads to sharpening of public and industrial risks. During a recession, economy generates less surplus value than it used to, and redistribution process and fictitious capital lessen. When a crisis hits its bottom, total output reaches its minimum and the last fictitious capital bubbles burst.

3. Fictitious capital in a modern economy.

The essence of fictitious capital remains the same since its appearance: it serves solely to redistribution of generated profit and accumulated income. Globalization, conducted in favor of the world capital centralization by financial oligarchy, not only assists the growth of fictitious capital's volume, but also provokes creation of its new forms, enlarging opportunities to manipulate fictitious capital. Main factors that stimulate this process are dollar-based world monetary system, development of the world loan market, conversion to floating exchange rates and oil shocks.

Unsteadiness of exchange rates, share quotations and interest rates is used as an element of a speculative game and assists development of hedging of the financial operations. Constant rate changes allow deriving an income from buying and selling securities and from commodity prices' fluctuations that are extremely vulnerable to speculations. On the edge of the XX and XXI centuries speculative factors formed 15-20% of the oil price on the market grace to the activity of hedgers and the fact that oil demand exceeded its supply [4]. This led to a critical fall of the oil prices in 2008 and 2014. Modern abilities of redistribution of assets and centralization of the cash flows significantly exceed previous ones.

Higher turnover rate and profit margin in financial markets (especially derivative market) than in production provokes moving of cash flows to speculative activities. As a result, a share of industrial and infrastructural projects declines in time in favor of financial ones, long-term operations give place to short-term and real investments are changed by speculations. This tendency boosts a growth of disproportionality of the world economy's development and, consequently, a rise of fluctuating of its main indicators, increase of it vulnerability and, as a result, strengthen global crisis. All forms of fictitious capital are used not only for profit redistribution, but also for centralization of the real capital in favor of the world financial oligarchy. Historically shares were a reflection of the invested real capital and were a title of ownership that granted an ability to devise an income, but then they acquired their own circulation on the stock market with different from their nominal value prices. Market prices' fluctuation, especially during the crisis, directly influences entities. During financial crises (especially beginning from the XX century) fictitious capital is used as a leverage for monopolization of industries, in other words for acquiring real capital (owning by small capitalists and generating real output) by big companies. In view of general chronic inflation and mounting economic crises accompanied with depreciation of securities and other forms of fictitious capital centralization process accelerates.

State bonds is another form of fictitious capital. Despite the fact that they are essentially used for financing large infrastructural and other long-term projects under state control, then these instruments gain their own circulation on the bond market. Nowadays a size of suck markets is extremely padded. USA national debt financing mainly by state bonds exceeds its GDP, same indicators of developed European countries reach 90% of GDP in view of a growth of inflation, unemployment rates and general recession in the world economy. Countries tend to use bonds as a tool of monetary politics that change money supply. Nevertheless, this is fictitious capital and it is unable to create surplus value and to revive economy truly.

In addition, the essence of other tools used by the government for increasing state income and project financing, such as privatization of state property and creation of pension funds are also operations with fictitious capital. Privatization means only a change of the title of ownership in favor of private parties and filling of state budget by fictitious capital with no real production behind. The same is the situation with pension funds that use their capital on financial markets and increase the volume of fictitious capital.

Nowadays in the light of global economic crisis issue of reserve currencies (that are not boosted by real production) is the main source of fictitious capital, mainly the US dollar. This sphere developed rapidly after creation of world loan market in 1958 (euromarket). In what follows, usage of excess fictitious capital as a tool of export of inflation to developing countries to acquire their real capital increased significantly after the first oil shock and the creation of Kingston exchange system in 1976 (liquidation of gold-exchange standard). The second oil shock provoked the creation of special development zones that together with euromarket brought down the last barriers of free circulation of fictitious capital on the supranational level for the benefit of the largest transnational companies and other groups of interest. Grace to well-coordinated actions of developed countries they succeed in liberalization of financial markets for consequent facilitation of the export of fictitious capital to developing countries (especially ex-communist countries), for which they have to pay with their real capital [2].

The general scheme of this process is the following: solvency crisis of developing countries, their corporations and entities compels them to search sources of financing on the euromarket. Nevertheless, foreign capital attracted this way is fictitious not only by its form, but also by the essence: in modern economy reserve currencies are almost not boosted by the real production. It is used to export inflation, to restore solvency of recipient-country's entities and to consult them to perform institutional reforms under terms stimulating acquisition of their real capital by the world financial oligarchy. Such loans make recipient-countries dependent not only economically, but also politically from exporters of fictitious capital.

In addition, countries include indicators of real and fictitious capital equally into their international balance of payment following the recommendations of IMF. Such mixing under one general category «capital» allows countries that have reserve currencies to drop disadvantages of their crisis development on other countries. Exporters of fictitious capital «produce» the most profitable commodity in the world – reserve currencies; it costs nothing, but it is accounted in their balance of payment equally with the imported real capital, such as raw materials, produced in countries that have no rights to issue reserve currencies. This process provides acquisition of real capital of countries and regions by the world financial oligarchy.

That is the reason why recipient-countries and members of monetary-based economic blocks (Greece and Ireland for Germany in EU, Puerto-Rico for the USA) become victims of the global crisis in the first place. Usually we observe the following situation: national economies that produce real production goes bankrupt because of the padded bubble of fictitious capital and have to spend their money on the debt servicing and not on the development of real capital; donor-countries buy up cheaply this real capital grace to devaluation of their national currency. Thus, recipient-countries pay for the fictitious capital with their real property, which leads to the fall of their citizens' standards of living. We witness a capital centralization on the supranational level and a «globalization with export of poverty to the periphery of the world economy» [3].

A scientific strategic economic planning is needed for recipient-countries to struggle against global economic crisis that allows liquidating its source – disproportionality. An exact distinction of real capital (that participates in real production) and fictitious capital (that circulates to redistribute income and wealth) is necessary. The practice of fictitious loans providing spontaneous capital centralization in favor of big capitalists must be ceased.

Real investments should be a switch of this plan with full supply of equipment, inventory and other material resources that allow increasing total output in the future. The main goal of planning of the economy is a calculation of production chains providing the maximization of the products' output required by final consumer (households, government, exporters and others) through implementing of new technologies. This process is described in the dynamic model of interindustry balance designed by scientist-cyberneticist N. I. Veduta. Cybernetic economic organization allows increasing significantly effectiveness of managerial decisions to escape economic cyclicity and to start a sustainable development of standards of living.

Conclusion

Fictitious capital refers to titles of ownership that allows capital centralization for big industry projects, but it always has its own circulation and provides redistribution of income and wealth in favor of their owners. It develops together with capitalism that is characterized by a spontaneous economic organization and cyclicity – constant changing of the periods of growth and recession.

A lack of coordination of production abilities and public needs leads to disproportionality of different industries, of supply and demand. The final reason to every economic crisis is a scarcity of mass consumption. This disproportionality is a basis for loan relationships and fictitious capital. Defaults in payments lead to insolvency, bankruptcy and a monetary crisis. At this time interest rates increase, security prices fall and big capitalists centralize capital. The first signs of recovery show entities that realize a need to change the business model. Every consequent crisis leads to strengthening of the world financial oligarchy and to the growing instability of the world economy with prevalent strongarm methods of problem solving.

Fictitious capital plays an important role in developing of the world model based on economic chaos through accelerating of capital centralization. A lack of funds to prevent insolvency entities and governments of developing countries supply with numerous forms of fictitious capital on primary and secondary markets mainly based on US dollars that are issued in exchange for the recipient-countries' real capital. Big capitalists centralize capital to acquire smaller entities at a lower price during subsequent economic crisis when bubble of fictitious capital «shrinks».

Countries need a clear vision of differences between real and fictitious capital on all levels to struggle with the crises and an understanding that keenness on speculative operations with higher profitability in short-term outlook leads to growth of fluctuation of all indicators and to increase of vulnerability in medium term outlook. In long term outlook this leads to systematic crises and failure of world financial system. Success in the field of switching from chaotic development and participating in international speculations, aimed at redistribution of the gross product with the help of fictitious capital to development of real capital and real production.

A crisis is not only a threat, but also a possibility of conversion to the new level of country's competitiveness in realization of a sustainable growth of standards of living. Only countries that gain a competitive advantage in public administration with the help of economic cybersystem (that enhances effectiveness of managerial decisions in providing a proportional sustainable economic growth) will be able to overcome modern global economic crisis. This relates not only to recipient countries of capital but also to donor-countries.

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