Study on economic crises under capitalism

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Abstract: *An economic crisis, characterized by negative economic growth, high unemployment, and reduced production, has significant global repercussions. Scholars have variously attributed crises to insufficient financial regulation and to fundamental contradictions of capitalism, particularly the tension between socialized production and private ownership of the means of production. While enhanced financial regulation has been proposed as a solution, recurrent crises since the Great Depression of 1929 suggest otherwise. This paper argues that the intrinsic contradictions of capitalism make economic crises unavoidable. Through case studies of the 1929 Great Depression and the 2008 global financial crisis, it demonstrates how profit-driven motives, speculative bubbles, excessive credit expansion, and insufficient financial regulation stem from the core contradiction between production socialization and private ownership. Even interventions like Keynesian economic policies have only temporarily mitigated these crises, failing to address the underlying issues. The conclusion posits that unless the fundamental contradictions of capitalism are resolved, cyclical economic crises will remain inevitable.*

Keywords: *economic crisis; Great Depression; 2008 global financial crisis*

1. Introduction

An economic crisis refers to a severe downturn in economic activities within a country or region, manifested by stagnant or negative economic growth, high unemployment rates, and declines in production and consumption, among a series of economic issues. In the context of globalization, the outbreak of an economic crisis can profoundly impact the economic development of countries worldwide. Therefore, the academic community has always paid significant attention to the causes of economic crises.

Currently, the academic community primarily holds several viewpoints. Some scholars believe that insufficient financial regulation is the main cause of economic crises. Thompson (2017) argues that the fundamental reason for the outbreak of economic crises lies in the lack of financial regulation and regulatory agencies, as well as the inherent fragility and instability within the financial system. However, from the economic crisis of 1929 to the present, regulatory systems have been continuously improved, yet economic crises continue to occur (Kuzucu, 2017; Mackintosh, 2014; Nützenadel and Torp, 2012), indicating that strengthening financial regulation is not the fundamental cause of economic crises[1-3].

Some scholars believe that the fundamental contradictions of capitalism, namely the contradiction between the socialization of production and the private ownership of the means of production, make economic crises inevitable (Buzan and Lawson, 2014; Marx and Engels, 2018; Ingham, 2008; Streeck, 2012). Ingham (2008) argues that the inherent contradictions of capitalism and its dependence on financial speculation make crises unavoidable, but state intervention can alleviate their impact to some extent. Buzan and Lawson believe that the inherent contradictions of capitalism include market dynamics, inequality, and global dependence, which together lead to cyclical crises, and they point out that policies can only mitigate but not fundamentally solve the problem.

Starting from the above viewpoints, this paper explains the principles by which the fundamental contradictions of capitalism make economic crises unavoidable, and uses the Great Depression of 1929 and the global economic crisis of 2008 as case studies[4-6].

2. Theoretical Analysis

The Marxist school believes that the fundamental reason for the recurrent outbreaks of economic crises is the unresolved basic contradiction of capitalism, namely the contradiction between the socialization of production and the private ownership of the means of production (Buzan and Lawson, 2014; Marx and Engels, 2018; Ingham, 2008; Streeck, 2012). This contradiction between the socialization of production and the private ownership of the means of production leads to an imbalance between production and consumption, supply and demand imbalances, insufficient effective demand, and contradictions between investment and consumption, ultimately triggering cyclical economic crises (Adler, 2007). Although, following the outbreak of a crisis, Keynesian measures advocating increased government regulation can help economic recovery—as seen in the New Deal implemented by Roosevelt during the Great Depression of 1929, which adopted Keynesian ideas to save the American economy—the fundamental contradictions of capitalism persist, making economic crises inevitable.

The high socialization of production is reflected in the refinement of the division of labour, increased collaboration, and technological advancements, which require substantial investment and coordination. However, the private ownership of the means of production, meaning the production tools, factories, and land are controlled by a few capitalists while the majority of workers can only sell their labour power (Adler, 2007). This structure shifts production goals from meeting social needs to pursuing private profits, leading to contradictions between production and consumption and unequal wealth distribution, restricting market demand and ultimately causing cyclical economic crises and social conflicts (Jossa, 2014). The contradiction between the socialization of production and the private ownership of the means of production leads to overproduction, market supply and demand imbalances, insufficient effective demand, and conflicts between investment and consumption (Adler, 2007). Firstly, overproduction and market supply and demand imbalances occur because capitalists pursue profit maximization, continuously increasing production capacity while workers' wage levels remain relatively low, limiting their consumption capacity and rendering them unable to purchase all the produced goods, resulting in oversupply and market saturation. Insufficient effective demand exacerbates this problem further; capitalists increase profits by lowering wages, which reduces workers' purchasing power, shrinks market demand, widens the wealth gap, and leads to overall insufficient social demand, production excess, and economic stagnation or recession. Additionally, the conflict between investment and consumption is also prominent; capitalists over-invest in pursuit of competition and monopoly, leading to production capacity exceeding market demand, forming economic bubbles, while consumption demand fails to increase simultaneously, causing product backlog, reduced investment returns, and ultimately triggering economic crises. Secondly, within capitalism, financial institutions and enterprises, in their pursuit of maximizing interests, pressure and lobby regulatory agencies using their substantial capital, resulting in insufficient regulatory efforts. Moreover, driven by interests, financial institutions and enterprises constantly seek new loopholes, making it difficult for regulatory agencies to control in a timely manner, ultimately making economic crises inevitable. Therefore, the core reason for the cyclical outbreaks of economic crises lies in the contradiction between the socialization of production and the private ownership of the means of production [7-13].

2.1 Case Study 1: The Economic Crisis of 1929

The economic crisis of 1929, also known as the "Great Depression," was the most severe global economic crisis of the 20th century. It began with the collapse of the U.S. stock market and quickly spread to the global economy (Federal Reserve Bank, 2015). Phenomena during the 1929 economic crisis, such as the stock market speculative bubble, excessive credit expansion, and lack of effective financial regulation (Federal Reserve Bank, 2015), can all be explained through the contradiction between the socialization of production and the private ownership of the means of production.

Firstly, the stock market speculative bubble originated from the contradiction between the economic boom and investment frenzy brought by the socialization of production and the profit-seeking behavior of enterprises and financial institutions. Due to investors purchasing large quantities of stocks, stock prices soared, causing a severe disconnection between the stock market and the actual economic situation. Moreover, enterprises and financial institutions exacerbated the stock market bubble by abusing securities businesses, using deceptive and manipulative techniques to sell high-risk securities to ordinary investors (Wilmarth, 2016). The stock market collapse, deflation, bank failures, and corporate bankruptcies resulted in millions falling into poverty, homelessness, and unemployment (Federal Reserve Bank of San Francisco, 1999; Wang, 2022).

Secondly, excessive credit expansion in the 1920s resulted from private capital's relentless pursuit of profit. Financial institutions issued numerous loans, encouraging consumption and investment, which overheated the credit market and led to a buildup of high-risk loans. This credit boom, masked by low inflation and slowing broad money growth, revealed the vulnerabilities of financial institutions and households when economic conditions worsened (Postel-Vinay, 2021). In response to economic overheating and credit expansion, the Federal Reserve implemented tight monetary policies at the onset of the Great Depression, further restricting bank liquidity (Ziebarth, 2013). As the economic situation deteriorated, the Federal Reserve failed to provide sufficient liquidity to support the banking system, resulting in banks being unable to withstand runs (Carlson, Mitchener, and Richardson, 2011; Richardson and Troost, 2009). This heightened market panic, led to numerous borrower defaults, and caused the banking system to collapse, triggering a comprehensive economic crisis. This scenario illustrates the contradiction between credit expansion driven by socialized production and the inherent risks of private ownership (Federal Reserve Bank, 2015).

Lastly, the lack of effective financial regulation was due to the substantial influence of private capital in the political and economic system, making regulatory policies ineffective. The financial market's inadequate regulation was partly because capitalists and financial institutions could influence policy-making, pushing for deregulation to achieve higher profits (Currie, 1934). Through lobbying and political influence, financial institutions weakened regulation, resulting in rampant speculative behavior, unsupervised financial innovations, and accumulated risks, ultimately making the financial system fragile and prone to crises. The financial crisis from 1930 to 1933 reduced the efficiency of credit allocation, increased costs, and decreased credit availability, thereby prolonging and deepening the Great Depression (Bernanke, 1983).

These phenomena collectively indicate that the inherent structural contradiction of the capitalist economy, namely the contradiction between the socialization of production and the private ownership of the means of production, inevitably led to the outbreak of the economic crisis of 1929. This crisis was not only the result of financial market and policy failures but also a concentrated manifestation of the intrinsic contradictions of the capitalist mode of production.

In the face of the economic crisis, the Keynesian measures advocating for strengthened government regulation played a significant role in achieving economic recovery. Roosevelt's New Deal, which involved active government intervention in the economy, implementation of large-scale public works and employment programs, establishment of social security systems, reforms of banking and monetary policies, and regulation of agricultural and industrial production, fully embodied Keynesian thought. These measures of the New Deal effectively stimulated demand, reduced unemployment, stabilized the financial system, and ultimately helped the United States to emerge from the Great Depression and achieve economic recovery by increasing public spending and expanding the money supply. However, it is worth noting that these methods did not fundamentally solve the problems of the Great Depression period or prevent the recurrence of economic crises [14-21].

2.2 Case Study 2: The Economic Crisis of 2008

The economic crisis of 2008, also known as the global financial crisis, was a period of worldwide economic turmoil triggered by the subprime mortgage crisis in the United States. Key issues during the 2008 economic crisis included the real estate bubble, high leverage operations by financial institutions, and inadequate financial regulation. These issues can be explained through the contradiction between the socialization of production and the private ownership of the means of production.

Firstly, the real estate bubble was driven by capitalists, who owned the means of production, engaging in excessive investment and speculation to maximize profits, despite the market demand and purchasing power being insufficient to support these investments. This imbalance between production and consumption led to an overheated real estate market, forming a bubble. Specifically, the U.S. real estate market experienced rapid growth in the early 2000s, with continuously rising house prices attracting many investors and speculators. Financial institutions issued numerous high-risk subprime loans, bundled these loans into complex financial products, and sold them in global markets (Mian and Sufi, 2011). This behavior amplified systemic risk, and when the real estate bubble burst, it caused widespread borrower defaults, a sharp decline in housing prices, and triggered a financial crisis.

Secondly, the high-leverage operations of financial institutions were driven by their pursuit of higher profits. By leveraging their investments, these institutions sought greater returns, but this approach significantly increased market risks. Prior to the 2008 financial crisis, many banks and investment firms engaged in high-leverage investments using complex financial instruments such as mortgage-backed securities and credit default swaps. These investments, exceeding their actual capital capacity, made the financial system extremely vulnerable (Criado and Rixtel, 2008; Wallace, 2011). When the subprime mortgage crisis erupted, asset values plummeted, and high-leverage operations left institutions unable to absorb the losses, triggering a chain reaction that led to a systemic collapse [22-26].

Finally, new regulatory loopholes also arose from the fundamental contradiction in capitalism, specifically the irreconcilable conflict between the socialization of production and the private ownership of the means of production. Despite global efforts to strengthen regulation after the 1929 economic crisis, including the establishment of the Securities and Exchange Commission and enhanced banking oversight, the contradiction between socialized production and private ownership led private capital to continually push against regulatory boundaries. Financial institutions and corporations influenced policy-making through lobbying and political donations, gradually weakening regulatory frameworks and creating potential loopholes (Igan and Mishra, 2014). For instance, financial innovations like mortgage securitization and credit default swaps made the financial system more complex and difficult to regulate (Michello and Deme, 2012; Shadab, 2009). This resulted in lowered credit standards and the issuance of many high-risk loans. Financial institutions and regulators failed to adequately identify and manage these risks, leading to a significant buildup of high-risk loans that severely impacted financial markets (Handorf, 2017). When the crisis struck, these loopholes prevented the financial system from effectively responding, plunging it into chaos.

These phenomena indicate that the inherent structural contradiction of the capitalist economy, namely the contradiction between the socialization of production and the private ownership of the means of production, inevitably led to the outbreak of the 2008 economic crisis. Socialization of production means that the production process requires more cooperation and coordination, while private ownership of the means of production means the privatization of profits and the socialization of risks. This contradiction is concealed during periods of economic prosperity but becomes apparent during crises, ultimately leading to cyclical economic crises (Federal Reserve Bank, 2015). Although we strengthened government regulation and improved the regulatory system after the Great Depression of 1929, leading to a gradual economic recovery, the fundamental contradiction of capitalism still persists [27-31].

3. Conclusion

Based on the above discussion, the contradiction between the socialization of production and the private ownership of the means of production is the fundamental cause of economic crises. There are two main reasons for the outbreak of the Great Depression of 1929: first, capitalists' excessive pursuit of profit expansion led to the stock market speculative bubble and excessive credit expansion; second, the lack of effective financial regulation. The Keynesian theories applied in Roosevelt's New Deal significantly strengthened the role of government regulation, helping the U.S. economy to recover quickly. However, this did not completely prevent the recurrence of economic crises. The 2008 economic crisis similarly stemmed from the same two major reasons: capitalists' excessive pursuit of profit leading to the real estate bubble and high leverage operations of financial institutions, and the lack of effective financial regulation. This indicates that merely strengthening financial regulation is not enough to fundamentally prevent economic crises. The few enterprises that control the means of production, in pursuit of greater profits, pressure financial institutions and continuously create regulatory loopholes to achieve capital expansion. Ultimately, the contradiction between overproduction and insufficient consumer purchasing power leads to the outbreak of economic crises.

Since the bankruptcy of Silicon Valley Bank in 2023, the specter of economic crisis has begun to loom again. Over the past decade, a new wave of profit-seeking by the bourgeoisie has turned to the technology industry (Martin, 2011). With the rapid proliferation of artificial intelligence (AI), the American financial sector quickly seized the opportunity for high-tech development, flooding the AI and related industries with large amounts of capital, leading to the continuous expansion of the tech bubble (Golovnin, 2021). The funding shortage triggered by the pandemic caused this bubble to burst, and the financial sector began a large-scale withdrawal from the AI field, which in turn caused a run on Silicon Valley Bank by tech companies (Lee and Phillips, 2016). Due to the failure of regulatory agencies to detect this situation in time, Silicon Valley Bank had insufficient reserves (Golovnin, 2021). The surge in withdrawals forced Silicon Valley Bank to liquidate its bond investment portfolio at a loss, exacerbating its financial distress, ultimately leading to its bankruptcy. This scenario is very similar to the issues caused by profit-seeking and insufficient financial regulation during the Great Depression of 1929 and the 2008 economic crisis. If the Federal Reserve cannot alleviate this problem in time, the next economic crisis may erupt in the near future.

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