6 Capitalism

What systems of economic organisation are possible?

What is special about capitalism?

What are the common features of capitalist economies?

Economic activity can be organised in various ways in the attempt to satisfy the social purposes identified in the preceding chapter. Communal, slave, feudal, capitalist, and socialist systems are the principal alternatives. Capitalism is evidently the predominant system at the present time. A careful definition of this system is required before studying how it works and making judgments about how well it works. This is attempted in this chapter by contrasting capitalism with other ways in which economic activity can be organised and then by looking in more detail at its distinctive features.

Alternative economic systems

Economic activity can be organised communally. In small social clusters, for example, people can gather to decide what they will produce, how the tasks will be shared, and how the fruits of their combined economic effort will be distributed and used. These decisions may be strongly influenced by custom and convention. Such has been the case in many tribal societies, a traditional focus in anthropological studies. The term 'primitive communalism' is applied in this context, although the economic and social processes may be highly sophisticated. Whether such communal organisation constitutes a viable basis for a large-scale, industrial economy is a moot point, but the principles and practices are relevant wherever cooperative behaviour needs to be nurtured.

A second possible means of economic organisation is slavery. Historically, slavery has been of considerable significance. Explicit use of force by one class (slave owners) over another (slaves) is the central organising principle here. Violence (or the threat of it) is the driver of economic activity, determining what gets done, by whom, how, where, and when. Slavery was commonplace in the Mediterranean lands, which were the cradle of modern Western civilisation, but it has also been crucially important in the more recent economic development of a number of countries. No analysis of the USA, for example, could sensibly ignore the role of slavery in its economic development: slaves from Africa were the principal source of plantation labour and, after emancipation, became a major source of labour in industrial cities such as Chicago and New York. A significant part of Great Britain's wealth in the eighteenth century derived from slavery, too. Coerced labour was also important in Australia, where convict labour was used to build infrastructure, laying the foundations for subsequent economic development. Indentured labour from the islands of the South Pacific also supplemented the workforce, especially on the Queensland sugar plantations. Elements of slavery persist today in many other nations: in the coercive aspects of prostitution, and in the use of child labour and prison labour to produce cheap products for global markets.

Feudalism is a third means of economic organisation. It, too, is of considerable historical and contemporary significance. Like slavery, it has coercive elements, but the core principle is mutual obligation. Under feudalism, the different social classes are linked by a system of mutual rights and obligations, usually based on traditional roles and beliefs. Serfs work on the land of landowners in exchange for social protection. This was the norm during the Middle Ages in Great Britain and much of Western Europe. Derivatives of this system continue to shape the economic development in many of the poorer nations today where a landowning class captures a big share of the economic surplus. Social acceptance of what might otherwise be deemed unacceptable inequalities of class, social position, and power may be maintained by cultural and religious ideologies. The demand for land reform is the usual signal of a move to challenge and change the residual feudal arrangements.

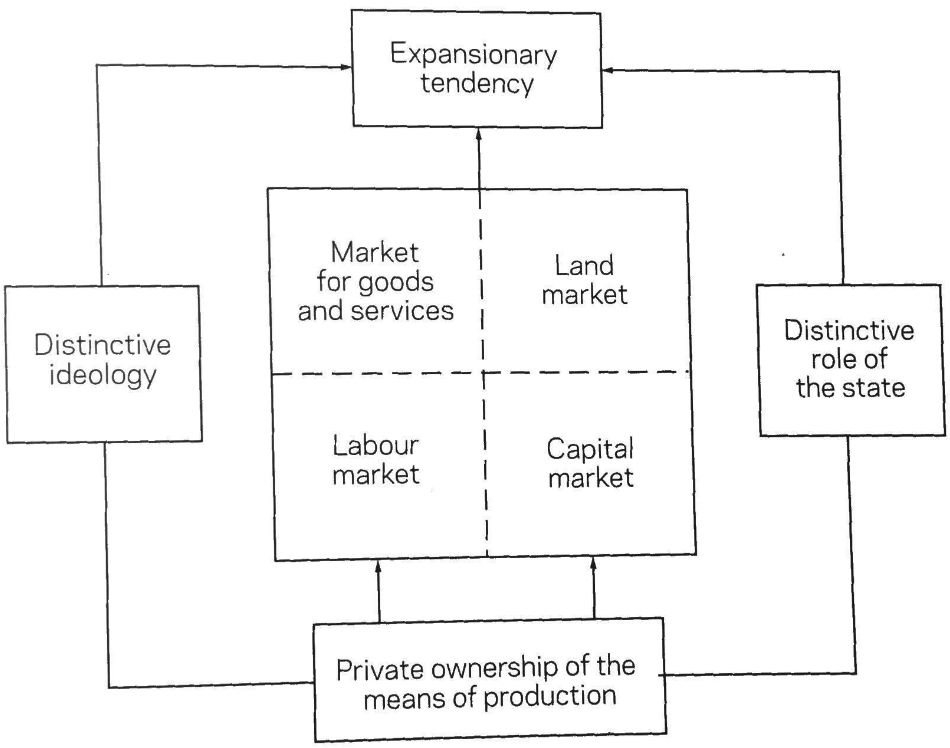
Capitalism is different from these other economic systems because financial considerations dominate. Control over capital becomes the key source of class power in this system. The quest for financial reward is the driving force shaping what is done, by whom, how, where, and when. It also determines who gets what in the distribution of rewards. Work is done for wages; business activity is undertaken for profit. The primacy of these pecuniary relationships is the basic defining feature of capitalism. There may be some collective decision-making, coercion, or mutual obligation, but it is the pervasiveness of financial arrangements that shapes the economy, society, and social values.[1]

Socialism may be regarded as the application of more consistently collectivist principles in the context of a modern, advanced economy. The nature of the economic activity performed, who performs it, how it is performed, and where and when it is performed are determined by a planning process. Therein lies much of the appeal of socialism, in principle at least, as a rational, democratic, and egalitarian set of socioeconomic arrangements. There were some twentieth-century experiments inspired by socialist ideals—in the former Soviet Union and in the People's Republic of China, for example—but whether these actually embodied socialist principles in practice is contentious. There is no single model: market socialism in which both planning and markets operate contrasts with a command economy in which the allocation of economic resources is determined by the state. Similarly, socialism may be based on either centralised or relatively decentralised decision-making processes. Whether socialism in any of these forms can be a viable basis for economic organisation in the twenty-first century is an ongoing controversy, but concerns about the sustainability of capitalism keep the quest for some such alternative permanently on the agenda.[2] Meanwhile, capitalism remains the dominant system of economic organisation on a world scale.

Defining capitalism

Capitalism cannot be defined as easily as we may define 'chair' or 'elephant': we do not so readily know it when we see it. It is necessary to define it in terms of a cluster of interconnected characteristics. The following eight features, summarised in Figure 6.1 below, identify what is special about the system. Each is not unique to capitalism, but together they indicate its distinctive character.

FIGURE 6.1 ELEMENTS IN THE CAPITALIST SYSTEM



Private ownership of the means of production

Capitalism is based on a distinctive system of property rights. Economic resources are characteristically owned by private individuals and institutions. Some land, natural resources, or public utilities may be owned by society as a whole. However, the basic capitalist principle is that economic activity is in the hands of private businesses for the purposes of making profit. These businesses may be run by individuals, such as sole proprietors of small firms. Others are run by bigger institutions that are legally recognised as entities, such as corporations owned by shareholders with limited personal liability.

The capacity of these property owners to derive income from their control over the means of production—the factories, offices, machinery, and equipment with which goods and services are produced—identifies them as a distinct class. How that capitalist class is constituted depends on how numerous are the businesses and how widespread are the shareholdings in the larger firms. Its existence as a class does not mean that internal conflicts of interests cannot occur—indeed, the owners of rival business enterprises are usually in competition with each other—but its defining feature is a common interest in the pursuit of profit.

Labour market

Under capitalism, those who do not own the means of production depend for their economic livelihood on the sale of their capacity to work. That requires the existence of a labour market (or, more usually, a set of labour markets, segmented according to region and occupation). The buyers of labour—those who own and control the means of production—interact there with the sellers of labour. Sometimes individual buyers and sellers directly negotiate wages and employment conditions, but the negotiation process is often mediated by trade unions, employer associations, and regulatory institutions that set the rules of the game.[3] It is the dependence of the bulk of the population on the sale of their capacity to work (in either manual or mental labour)—that is, the existence of a working class—that is the common feature.

Under capitalism workers are free in that, unlike slaves or serfs, they are not tied to a particular employer by physical coercion or social convention. However, their freedom is a constrained freedom. It is the freedom, and the necessity, to sell their capacity to work. This is why capitalism is sometimes said to be a system of 'alienated labour', or a system in which labour is treated as a commodity.

Capital market

Those who establish and run capitalist businesses need funds for that purpose. They need financial capital before they can employ the means of production in order to make goods and services. So, an institution (or group of institutions) is necessary for channelling funds from savers into the hands of businesses or people who can then invest those funds productively. Banks carry out that institutional function by making loans to businesses. Indeed, they can lend much more than they have in deposits, effectively creating money in the process. As such, banks are key capitalist institutions, facilitating the conversion of savings into investment as well as being profit-seeking entities themselves.

The most characteristic capital market institution is the stock exchange. This is where shares in companies are sold to the public, and where the owners of those shares can sell them to others. Not surprisingly, the stock exchange is sometimes held to be the ultimate symbol of capitalism. It is a place where fortunes can be made or lost. However, it is really an adjunct to the productive economy, not in itself a place where wealth is created. Indeed, large companies often make such enormous profits that they can finance expansion of their businesses without needing to raise capital on the stock exchange. Capital markets usually continue to exert some discipline on those businesses, though, if only because the threat of takeover becomes more likely if their share price falls.

Land market

Land is of fundamental importance in all types of economic organisation. In rural areas, its fertility and management determines its capacity to contribute that most basic of human needs: food. In an urban context, its use has a major bearing on the effectiveness of cities as focal points of modern economic life. So, how land is owned, allocated, and regulated has major socioeconomic implications.

Under capitalism, land is characteristically privately owned and is usually allocated through market processes—subject to varying degrees of regulation by the state. Land, like labour and capital, is bought and sold in the market. Arguably, this is not essential for capitalism: land could be owned collectively through the state and allocated or leased to households and businesses. As such, the form of land ownership is not such a fundamentally defining feature of the economic system under capitalism as it is under, say, feudalism. However, under capitalism, the very generality of market processes tends to make land yet another tradeable commodity.

Markets for goods and services

Capitalism is a system of generalised commodity production. Goods and services are typically produced for exchange in the market. That is what makes those goods and services commodities: they are items produced for sale rather than for personal use by their producer.

The processes of exchange sometimes involve direct interaction between buyer and seller, but usually they are mediated by the institutions of wholesale and retail trade. Shopping is the name of the game. Indeed, shoppers play a crucial role in the capitalist system as a whole because, if their purchases do not match the volume and array of commodities produced, economic crises can occur. No wonder the emphasis on consumerism is so pervasive under contemporary capitalism, and no wonder so many resources are channelled into marketing and sales promotion.[4]

Distinctive role of the state

The fifth characteristic of capitalism is, at first sight, more surprising. Surely, one might think, if capitalism is primarily a market economy, then there is no significant role for the state. Not so. In all political economic systems other than anarchism, the state has a significant presence. The key point is what form the state presence takes.

Under capitalism, functions of the state relate directly to the prevailing property rights, and market and class relationships. So the state regulates and enforces the property rights on which the capitalist economy is based. It determines the rules underpinning the operation of markets for labour, capital, land, and commodities. It acts as an umpire in respect of rivalries between businesses that might otherwise be sources of economic instability. It usually seeks to redistribute market incomes, at least to the extent necessary to ensure social stability. It may also be directly engaged in the provision of goods and services that are not provided by the market: fire fighting, law enforcement, and defence, for example. The nature and extent of these state activities is, of course, the focus of continued political debate. The main point here is that capitalism is not synonymous with a pure market economy.

Distinctive ideology

All economic systems have prevailing ideologies associated with them: these are systems of belief that make the system seem legitimate. The dominant ideologies are commonly shaped by, or reflect, the structure of the economy. Determining the direction of causation is a highly contentious exercise, but some broad correlations are clear enough. For instance, consumerist ideologies that regard material goods as the source of personal satisfaction and social status are not unique to capitalism, but they seem to reach their zenith in this type of economy. *Homo economicus*, or 'rational economic person', is fostered by capitalist economic interests.

An emphasis on competitiveness is similarly predictable in an economic system based on competing market interests (although monopoly may be as prevalent as competition in actually existing capitalism). By contrast, ideologies emphasising cooperation can be expected to be more prominent where the economic organisation is collectivist in character. Both types of ideology are usually present in uneasy alliance with each other. However, to the extent that ideology gives legitimacy to an economic system, it is not surprising that the predominant capitalist ideology is consumerist and competitive.

Expansionary tendency

Last, it is pertinent to note the dynamic character of capitalism. As a system driven by the quest for profit, it is geared for growth. This is not to say that growth is always achieved. Indeed, the history of capitalism worldwide is one of alternating periods of boom and slump. But this particular type of economic system works best when it is growing. It may be said that, like a bicycle, capitalism requires forward motion for its stability. That is why periods of recession or economic stagnation precipitate dramatic processes of economic restructuring, as described in Chapter 3.

This dynamism is capitalism's most obvious strength, the source of its capacity to reproduce itself, expand, and adapt. It is also the source of fundamental tensions. There is perpetual conflict between the profit-seeking interests and the broader social goals. There is also a fundamental tension between this growth-orientated economy and the finite resources of the planet on which it exists, a tension that is manifest in growing environmental stress.

Conclusion

Defining capitalism in terms of a cluster of key characteristics provides a description of an ideal model. It is not necessarily ideal in the normative sense of being desirable (we consider those pros and cons later), but in the sense of being a simplified abstraction. The question remains: Do economies in the real world approximate this ideal model? In other words, are the economies of the USA, the UK, Australia, Sweden, Singapore, and other capitalist nations essentially the same? Posed in this blunt manner, the question has to be answered in the negative. There are significant differences in the range of economic functions undertaken by the state. There are also differences between those countries in the economic institutions and ideologies that shape how markets for labour, capital, and land operate. In the USA, for example, the state has been more concerned with supporting the interests of capital and the functioning of the capitalist market economy, whereas in Sweden the state has played a substantial role in the redistribution of income and in economic and social planning. On the other hand, the state in the USA is highly interventionist on a world scale, much more so than Sweden (or any other country), because of its role as self-appointed policeman of international capitalism.[5]

These examples illustrate *varieties of capitalism* in different national contexts. The variations are partly explicable in terms of the historical evolution of the countries concerned. They can also be analysed in terms of the relationships between the economy and society discussed in Chapter 5: the distinctive national characters of nature, market, state, class, gender, ethnicity, social capital, and ideology. If we are to understand how different countries' economies work, detailed historical and institutional study is necessary on a case-by-case basis. The distinctive methodological position being argued here—the punchline to this chapter—is that an analysis of *capitalism in general* is a necessary prelude. Once we understand the fundamental features of the system, we can then layer on the details necessary for understanding the complexities of the real world in which we live.

KEY POINTS

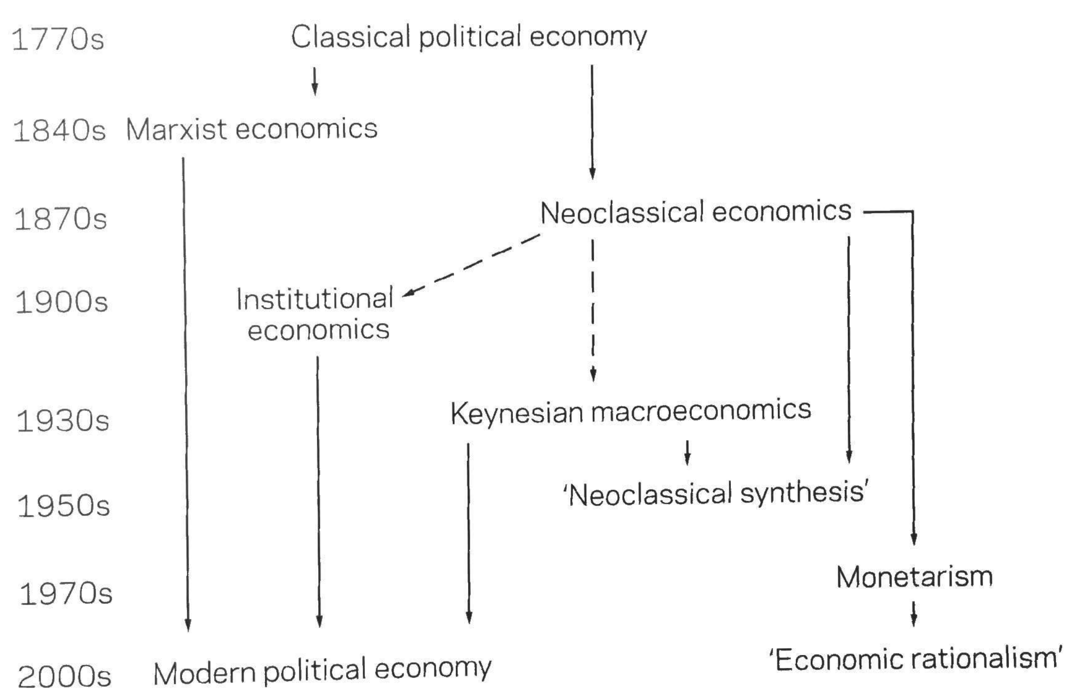
- There are many different systems of economic organisation: communal, slave, feudal, capitalist, socialist, and numerous possible blends thereof.
- Capitalism can be defined in terms of its particular characteristics: the private ownership of the means of production, markets for labour, capital, land, and goods, a distinctive role for the state, legitimising ideologies, and an expansionary tendency.
- These systemic characteristics make it possible to analyse capitalism in general, notwithstanding significant national varieties of capitalism in practice.

phenomena. Economists are continually modifying their theories—the professional journals are full of such adaptations—but the core principles have remarkable tenacity. The political purposes that economics serves also have to be taken into account in any serious study of the development of schools of economic thought.

An historical overview

The political character of economic thought is most obvious when the subject is studied in historical perspective. Over more than two and a quarter centuries, paralleling the development of the capitalist economy, exponents of rival schools of economic thought have argued about how capitalism works. Figure 7.1 provides a simple summary of the evolving currents of economic analysis.

FIGURE 7.1 THE HISTORY OF ECONOMIC THOUGHT



Note: This chart of the main currents of political economic analysis in historical perspective simplifies the complex history of the subject; however, it does draw attention to the principal avenues of continuity (represented by the continuous vertical lines) and discontinuity (represented by the dotted lines). In the former, the new school of thought is a development from the previous one; in the latter, it is a reaction against it.

Each of these competing schools of thought can be understood in terms of the changing economic conditions of the time, the influence of particular economic interests, the influence of prevailing intellectual fashions, and the innovative ideas of great economic thinkers.

Much of the rest of the book is an illustration of these themes. The prefatory remarks in the rest of this chapter set the scene for the more detailed investigations that follow.

It is sensible to begin in the late eighteenth century, when capitalism was clearly emerging from feudalism in Great Britain and, more slowly, in other nations in which capitalist economic relationships were eventually to predominate. This was the period when

Adam Smith wrote his seminal book *An Inquiry into the Nature and Causes of the Wealth of Nations* (usually shortened to *The Wealth of Nations*) and when what we now call classical political economy developed. Of course intelligent people had reflected on the economic conditions before then. However, with classical political economy came the emergence of a specifically capitalist economics.

The classical political economists were concerned with studying the economic character of the society in which they lived. They analysed the capacity of an economic system based on market exchange, rather than customary relationships or state management, to increase national wealth. They believed such a system opened up opportunities for individual initiative, increased productivity, and aided the growth of trade. Some did have grave reservations about whether the mass of the working population would experience rising living standards, but history was on the march, and the development of economic liberalism provided its justification. It continues to have a major influence today.

The neoclassical economists built on the foundations of classical political economy. For more than a century they have been a consistently strong source of support for the view that free markets produce efficient outcomes. Emerging in the late nineteenth century, neoclassical theory provided a formal modelling of equilibrium conditions in competitive markets. This was clearly an attempt to put economics—then newly separated from the study of history and politics—on a more scientific basis. Whether the result was—and is—actually more scientific or more ideological, showing capitalism in an unrealistically favourable light, is a seemingly perpetual controversy.

Meanwhile, Marxist economists, also starting from a basis in classical political economy, developed a markedly different interpretation of capitalism. They contend that it generates pervasive economic inequality, social conflict, and periodic crises. This quite different analysis of the capitalist economy also emerged in the nineteenth century, responding to the economic, social, and political transformations then taking place. The pioneering analysis of Karl Marx, and his collaborator Friedrich Engels, continues as a foundation for radical critiques of the capitalist system, such as those advanced by critics of the current corporate globalisation process and the global financial crisis. On this reasoning, only a fundamental transformation of the political economic system can reconcile economic concerns with social justice and progress.

Between these extremes are reformist perspectives, such as those associated with John Maynard Keynes and with the institutional tradition of economic analysis. These also warrant careful consideration, for they put particular focus on what governments—given the political will—can do to eradicate unemployment, redistribute incomes more equitably, and promote more balanced economic and social development.

Institutional economics was inspired by the critical social analysis of the dissident American economist Thorstein Veblen, writing a century ago. Veblen was deeply critical of capitalism, but his critique was quite different from Marx's, in that he emphasised the social manifestations of business and consumer behaviour rather than the forces for change generated by class conflict. The political tenor of the institutional economics tradition after

Veblen has usually been more concerned with the amelioration of the problems of capitalism than with a revolutionary challenge to the system. The development of the welfare state in the twentieth century was influenced by these institutional economists, as well as by other social reformers.

Keynes, writing between the First and Second World Wars when unemployment was particularly persistent, also saw economic analysis as a means towards reform. He considered the capitalist system 'morally objectionable', but thought it better than the possible alternatives of communism and fascism, support for which was then growing internationally. Understanding the causes of unemployment, and positing solutions for it through economic policy, would, on this reasoning, make a particularly valuable social contribution. As with institutional economics, the Keynesian perspective is one in which the state is central. As historian Eric Hobsbawm put it, Keynes 'wished to save the essentials of a capitalist system but realised that this could be done only within the framework of a strong and systematically interventionist state'.[5] It was in contributing to such reforms, Keynes said, that economists can be the trustees of 'the possibilities of civilisation'.[6]

The ideas of Keynes, reinterpreted in a mechanistic form to make them more compatible with neoclassical theory, became the basis for a new orthodoxy during the three decades after the Second World War. This was the era of the 'neoclassical synthesis', an uneasy blend of Keynesian macroeconomics and neoclassical microeconomics. It coincided with the years of the long boom when, for the advanced industrial capitalist nations at least, there did indeed seem to be continuous economic growth and full employment. The collapse of that long boom in the 1970s led to a major assault on Keynesian economics, both in theory and policy. Western capitalism saw the impact of a resurgent pre-Keynesianism, known as monetarism, which contended that capitalism would work best when government interfered least.

Monetarism led to a general revival in the last three decades of various forms of free-market economics. The ideas of Adam Smith have been blended with propositions from neoclassical theory and neoliberal politics to show the benefits of releasing capitalism from the constraints imposed by trade unions and unwarranted government 'intervention'. This 'new classical economics' sets aside Smith's reservations about markets and businessmen, and overlooks the fundamental differences between capitalism in his time and ours.

Modern political economists express profound reservations about this neoliberal free-market economics. They argue that it fails to provide a coherent means of understanding contemporary capitalism, and that, in practice, its policy prescriptions accentuate economic inequality, instability, and insecurity. They put the case for drawing on the dissident traditions of Marxist economics, institutional economics, and the economics of Keynes, and for building a more critical analysis of capitalism that takes account of contemporary economic problems (as reviewed in Chapter 4).

This, in a nutshell, is the story of the competing schools of economic thought. It is the story of ongoing rivalry—partly methodological and partly political in character—within this contested but highly influential discipline. It illustrates the controversial character of economic ideas about capitalism over more than two centuries.

Have we come a long way? Or are there elements of circularity, repetition, and even regress in the development of economic thought? Has the inherently political nature of economics impeded our understanding of modern capitalism? And, on what basis can future progress be made in understanding the economic system and in changing it for the better? A prerequisite for such progress is understanding how we reached this point. That, essentially, is the rationale for studying political economic analysis in historical perspective. It is the rationale for much of what follows in the rest of this book—teasing out what economic ideas are relevant to understanding the economy and dealing with the political economic challenges that confront us.[7]

Conclusion

Understanding how the capitalist economic system works, for better or worse, is the principal concern of political economy. Even the interpretation of the economy as a system implies an analytical stance, because 'system' implies regularities of behaviour and features that, in principle at least, can be understood and managed.

However, there is no unanimity on how to fashion this understanding. Rather, an economic system such as capitalism can be understood in various ways. Those different ways of seeing exist partly because of methodological differences regarding the best way to construct theory and partly because of differences in value judgments associated with rival political philosophies. Moreover, as an historical analysis of the discipline reveals, there is a strong connection between the contest of economic ideas and the conflict of economic interests.

KEY POINTS

- Theory is essential in understanding the economic system because it enables us to identify key elements and patterns in otherwise intractably complex circumstances.
- Rival economic theories can be characterised as competing schools of thought, interpreting capitalism in markedly different ways and resulting in strikingly different implications for economic policy.
- Understanding classical political economy, neoclassical economics, Marxian economics, institutional economics, and Keynesian economics is an essential foundation for the development of modern political economy.