ECONOMICS FOR EVERYONE

A SHORT GUIDE TO THE ECONOMICS OF CAPITALISM

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NAOMI KLEIN
author of *No Logo* and *The Shock Doctrine: The Rise of Disaster Capitalism*

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The Economy and Economics

Take a walk

The economy must be a very complicated, volatile thing. At least that's how it seems in the business pages of the newspaper. Mind-boggling stock market tables. Charts and graphs. GDP statistics. Foreign exchange rates. It's little wonder the media turn to economists, the high priests of this mysterious world, to tell us what it means, and why it's important. And we hear from them several times each day – usually via the monotonous "market updates" that interrupt most news broadcasts. Company X's shares are up two points; company Y's are down two points; the analysts are "bullish"; the analysts are "bearish."

But is all that financial hyperactivity really what the economy is about? Is economics really so complex and unintelligible? Should we trust the "experts" with it all? Maybe we should find out what's going on for ourselves.

Forget the market updates. Here's a better way to find out about the economy – *your* economy. Take a walk. And ask some questions.

Start at the front door of your own household. How many people live there? What generations? Who works outside the household, and how much do they earn? How long have they been working there? How long do they plan to keep working, and how will they support themselves when they retire? Who performs which chores inside the household? Are there any children? Who cares for them? Does anyone else in your home require care? Do you own your house or apartment, or do you rent it? If you rent it, from whom? If you own it, how did you pay for it? What shape is it in?

Now walk through your neighbourhood, and the next neighbourhood. Are the homes or apartments all roughly the same, or different? Does everyone have a home? Do most people have jobs? What sorts of jobs? Are they well off? Can they comfortably pay for the things they and their families need?

Watch your neighbours going off to work, school, or other destinations. How are they travelling? In their own cars? On public

transport? Walking? How much money, time, and physical space i
devoted in your neighbourhood to "getting around"?

Is there a school in your neighbourhood? A hospital? A library
Who pays for those buildings? Who works there? How do thos
facilities compare with the private homes and businesses aroun
them? Are they newer, or older? Nicer, or shabbier? Is there a park i
your neighbourhood? Is there anywhere else a person can go withou
having to pay money?

Are the streets clean? If so, who cleaned them? Is the air fresh o
smoggy? Are there any parks in your neighbourhood? Can peopl
in your neighbourhood safely drink the water from their taps? How
much do they pay for that water? And to whom?

Walk through the nearest shopping district. What kinds of product
are displayed in the windows? Were any of them produced withi
100 miles of your home? Elsewhere in your country? In anothe
country? Can your neighbours afford most of what is on display?
Are they usually happy with their purchases, or disappointed? Do
they pay with cash, bank cards, or credit cards? Can they afford
what they buy?

Now walk to a local bank branch and see what's happening inside. Compare what you see (deposits, withdrawals, loans) with the activities you read about in the business pages of the newspaper (leveraged buyouts, financial speculation, foreign exchange). Which matters more to day-to-day life in your neighbourhood?

This is a good time to stop at a café. Pull out a pencil and paper. List your approximate monthly income. Then list how much of it goes to the following categories: rent or mortgage (including utilities); income taxes; car payments or public transport passes; groceries; other "stuff" (merchandise); and going out (entertainment). Can you comfortably pay your bills each month? Do you regularly save? Is your income higher than it was five years ago, lower, or about the same? If you had a little more income, what would you do with it? If you walked back to that bank and asked for a loan, would they give you one?

Apart from the places we've mentioned (schools, stores, and banks), what other workplaces are visible in your neighbourhood? Any factories? What do they produce, and what shape are they in? Any professional or government offices? Other services? Can you see any office buildings from your neighbourhood? Who works there? Can you guess what they do? Imagine the conditions in those offices (spaciousness, quality of furnishings, security, caretaking), and compare them to conditions inside your local school.

Have any new workplaces opened up recently in your neighbourhood? If so, what do they do? Did you see any "help wanted" signs posted in local workplaces? What kinds of jobs were they advertising for?

Now you can return home. Congratulations! You've done a lot more than just take a stroll. You've conducted a composite economic profile of your own community. It has no statistics, charts, or graphs (though you could add those if you wish, with a bit of work at the local library). But just by walking around your neighbourhood, you have identified the crucial factors determining economic affairs in your community:

- **Work** Who works? Who works inside the home, and works outside the home? Are they employed by someone else (and if so, who?), or do they work for themselves? How much do they get paid? Is it hard to find a job?

- **Consumption** What do people need to stay alive? What do they want, to make their lives better? How do they pay for it all?
- **Investment** Private companies and public agencies must invest in maintaining and expanding their facilities and workplaces, or else the economy (and your neighbourhood) goes quickly downhill. Who is investing? How much? On what types of projects?
- **Finance** Most economic activity (but not all) requires money. Who creates and controls that money? Who gets to spend it? What do they spend it on?
- **Environment** Everything we do in the economy requires space, air, and inputs of natural materials. Is the natural environment being run down by the economy, or is it being sustained?

These are the building blocks from which the most complicated economic theories are constructed: work, consumption, investment, finance, and the environment. And they are all visible, right there in your neighbourhood.

Don't ever believe that economics is a subject only for "experts." The essence of economics is visible to everyone, right there in your own 'hood. Economics is about life – *your* life.

What is the economy?

The economy is simultaneously mystifying and straightforward. Everyone has experience with the economy. Everyone participates in it. Everyone knows something about it – long before the pinstripe-wearing economist appears on TV to tell you about it.

The forces and relationships you investigated on your walk are far more important to economic life than the pointless ups and downs of the stock market. Yet our local economic lives are nevertheless affected (and disrupted) by the bigger and more complex developments reported in the business pages.

At its simplest, the "economy" simply means all the work that human beings perform, in order to produce the things we need and use in our lives. (By work, we mean all productive human activity, not just employment; we'll discuss that distinction later.) We need to organize and perform our work (economists call that PRODUCTION)

And then we need to divide up the fruits of our work (economists call that DISTRIBUTION).

What kind of work are we talking about? Any kind of work is part of the economy, as long as it's aimed at producing something we need or want. Factory workers, office workers. Executives, farmers. Teachers, nurses. Homemakers, homebuilders. All of these people perform productive work, and all of that work is part of the economy.

What do we produce when we work? Production involves both goods and services. GOODS are tangible items that we can see and touch: food and clothes, houses and buildings, electronics and automobiles, machines and toys. SERVICES are tasks that one or several people perform for others: cutting hair and preparing restaurant meals, classroom instruction and brain surgery, transportation and auditing.

Where do we perform this work? Productive work occurs almost everywhere: in private companies, in government departments and public agencies, and in the home. In cities, in towns, on farms, and in forests.

Why do we work? We must survive, and hence we require the basic material needs of life: food, clothing, shelter, education, medical care. Beyond that, we want to get the most out of our lives, and hence we aim for more than subsistence. We want a greater quantity, and a greater variety, of goods and services: for entertainment, for travel, for cultural and personal enrichment, for comfort. We may also work because we enjoy it. Perversely for economists (most of whom view work solely as a "disutility"), most people are happier when they have work to do – thanks to the social interaction, financial well-being, and self-esteem that good work provides.

How do we distribute, and eventually use, the economic pie we have baked together? In many different ways. Some things are produced directly for our own use (like food grown in a garden, and then cooked in a household kitchen). Most things we must buy with money. We are entitled to consume certain products – like walking down a paved street, listening to the radio, or going to school – without directly paying anything. Importantly, some of what we produce must be re-invested, in order to spark even more economic activity in the future.

So when you think about the "economy," just think about work. What work do we do? What do we produce? And what do we do with what we've produced?

The economy and society

The economy is a fundamentally *social* activity. Nobody does it all by themselves (unless you are a hermit). We rely on each other, and we interact with each other, in the course of our work.

It is common to equate the economy with private or individual wealth, profit, and self-interest, and hence it may seem strange to describe it as something "social." Indeed, free-market economists adopt the starting premise that human beings are inherently selfish (even though this assumption has been proven false by biologists and anthropologists alike).

> **Economics Matters**
>
> "The mode of production of material life determines the social, political and intellectual life process in general."
>
> Karl Marx, German philosopher and economist (1859).
>
> "It's the economy, stupid."
>
> James Carville, political advisor to US President Bill Clinton (1992).

In fact, the capitalist economy is not individualistic at all. It is social, and in many ways it is cooperative. The richest billionaire in the world couldn't have earned a dollar without the supporting roles played by his or her workers, suppliers, and customers. Indeed, our economic lives are increasingly intertwined with each other, as we each play our own little roles in a much bigger picture. That's why most of us live in cities (where the specialized, collective nature of the economy is especially visible). And that's how we can interact economically with people in other countries, thousands of miles away.

The economy is about work: organizing it, doing it, and dividing up its products. And at work, one way or another, we interact with other people.

The link between the economy and society goes two ways. The economy is a fundamentally social arena. But society as a whole depends strongly on the state of the economy. Politics, culture, religion, and international affairs are all deeply influenced by the progress of our economy. Governments are re-elected or turfed from

office depending on the state of the economy. Family life is organized around the demands of work (both inside and outside the home). Being able to comfortably support oneself and one's family is a central determinant of happiness.

So the economy is an important, perhaps even dominant, force in human development. That doesn't mean that we should make "sacrifices" for the sake of the economy – since the whole point of the economy is to meet our material needs, not the other way around. And it certainly doesn't mean that we should grant undue attention or influence to economists. But it does mean that we will understand a great deal about our history, our current social reality, and our future evolution as a species, when we understand more about economics.

What is economics?

Economics is a social science, not a physical science. (Unfortunately, many economists are confused on this point! They foolishly try to describe human economic activity with as much mechanical precision as physicists describe the behaviour of atoms.) Economics is the study of human economic behaviour: the production and distribution of the goods and services we need and want.

This broad field encompasses several sub-disciplines. Economic history; money and finance; household economics; labour studies and labour relations; business economics and management; international economics; environmental economics; and others. A broad (and rather artificial) division is often made between MICROECONOMICS (the study of the economic behaviour of individual consumers, workers, and companies) and MACROECONOMICS (the study of how the economy functions at the aggregate level).

This all seems relatively straightforward. Unfortunately, the dominant stream in modern economics (NEOCLASSICAL ECONOMICS, which we'll discuss more in Chapter 4) makes it more complicated than it needs to be. Instead of addressing broad questions of production and distribution, neoclassical economics focuses narrowly on *markets* and *exchange*. The purpose of economics, in this mindset, was defined by one of its leading practitioners (Lord Lionel Robbins) back in 1932, in a definition that is still taught in economics courses today:

"Economics is the science which studies human behaviour as a relationship between given ends and scarce means which have alternative uses."

Embedded in this definition is a very peculiar (and rather dismal) interpretation of economic life. Scarcity is a normal condition. Humans are "endowed" with arbitrary amounts of useful resources. By trading through markets, they can extract maximum well-being from that endowment – just like school kids experience greater happiness by trading their duplicate superhero cards with one another in the playground. An "efficient" economy is one which maximizes, through trade, the usefulness of that initial endowment – regardless of how output is distributed, what kinds of things are produced, or how rich or poor people are at the end of the day. (This curious narrow concept of efficiency is called ALLOCATIVE EFFICIENCY.)

As we'll learn later in this book, by defining the fundamental economic "question" in this particular way, neoclassical economics misses many important economic issues related to production, innovation, development, and fairness.

I prefer to keep things simple. We'll stick with a much broader definition of economics: the study of how humans work, and what we do with the fruits of our labour. Part of this involves studying markets and exchange – but only part. Economics also involves studying many other things: history, technology, tradition, family, power, and conflict.

Economics and politics

Economics and politics have always gone hand-in-hand. Indeed, the first economists called their discipline "political economy." The connections between economics and politics reflect, in part, the importance of economic conditions to political conditions. The well-being of the economy can influence the rise and fall of politicians and governments, even entire social systems.

But here, too, the influence goes both ways. Politics also affects the economy – and economics itself. The economy is a realm of competing, often conflicting interests. Determining whose interests prevail, and how conflicts are managed, is a deeply political process. (Neoclassical economists claim that anonymous "market forces" determine all these outcomes, but don't be fooled: what they call the "market" is itself a social institution in which some people's interests are enhanced at the expense of others'.) Different economic actors use their political influence and power to advance their respective economic interests. The extent to which groups of people tolerate

economic outcomes (even unfavourable ones) also depends on political factors: such as whether or not they believe those outcomes are "natural" or "inevitable," and whether or not they feel they have any power to bring about change.

Finally, the social science which aims to interpret and explain all this scrabbling, teeming behaviour – economics – has its own political assumptions and biases. In Chapter 4 we'll review how most economic theories over the years have been motivated by political considerations. Modern economics (including this book!) is no different: economics is still a deeply political profession.

Measuring the economy

GROSS DOMESTIC PRODUCT (GDP) is the most common way to measure the economy. But beware: it is a deeply flawed measure. GDP adds up the value of all the different goods and services that are produced *for money* in the economy. GDP is thus one measure of the total value of the work we do – but only the work we do for money.

In the private sector of the economy, GDP is based on the market prices of everything that's bought and sold. In the public and non-profit sectors, it is based on the cost of everything that's produced. In both cases, statisticians must deduct the costs of the many inputs and supplies purchased in any particular industry, from the total value produced by that industry. (This is so that we don't double-count the work that went into all those inputs.) In this way, GDP is designed to only include the VALUE ADDED by new work at each stage of production.

An obvious drawback of GDP is that it excludes the value of work that is *not* performed for money. This is a highly arbitrary and misleading exclusion. For example, most people perform unpaid chores in their households, and many must care for other family members (especially children and elders). Some of this household work can be "outsourced" to paid cleaners, nannies, and restaurants (the richer you are, the more you can outsource), in which case it is included in GDP. But if you "do it yourself," then it doesn't count! Volunteer work and community participation are other forms of valuable, productive work excluded from GDP.

This phony distinction has big consequences for how we measure the economy. Unfortunately, things that we measure often take on extra importance (with the media, and with policy-makers), purely

Table 1.1 GDP and Human Well-Being

Country	Human Development Index Rank (HDI)	GDP Rank	GDP Rank – HDI Rank*	GDP per Capita (US$)	Life Expectancy (years)	Educational Attainment Index†
Norway	1	4	3	38,454	79.6	.99
Iceland	2	5	3	33,051	80.9	.98
Australia	3	14	11	30,331	80.5	.99
Ireland	4	3	–1	38,827	77.9	.99
Sweden	5	16	11	29,541	80.3	.98
Canada	6	10	4	31,263	80.2	.97
Japan	7	18	11	29,251	82.2	.94
US	8	2	–6	39,676	77.5	.97
UK	18	13	–5	30,821	78.3	.97
China	81	90	9	5,896	71.9	.84
India	126	117	–9	3,139	63.6	.61
Human Development "Over-Achievers":						
Uruguay	43	62	+19	9,421	75.6	.95
Cuba	50	93	+43	5,700	77.6	.93
Armenia	80	112	+32	4,101	71.6	.91
Madagascar	143	169	+26	857	55.6	.66
Human Development "Under-Achievers":						
Hong Kong	22	12	–10	30,822	81.8	.88
Saudi Arabia	76	45	–31	13,825	72.0	.72
Turkey	92	70	–22	7,753	68.9	.81
Equatorial Guinea	120	30	–90	20,510	42.8	.77
South Africa	121	55	–66	11,192	47.0	.80

Source: UN Human Development Report, 2006.

* A positive score indicates better HDI ranking than GDP ranking.

† Index based on literacy rate and combined school enrolment.

because they *can* be measured. GDP underestimates the total value o[f] work performed in the economy, and hence misjudges our productivity. It undervalues the unpaid work done within our homes and ou[r] communities. Because of sexism at home and in the workplace, mos[t] of that unpaid work is done by women; hence, GDP underestimate[s] the economic contribution of women.

GDP and Human Well-Being

The United Nations Development Program produces an annual ranking of countries according to their "human development." The UN defines human development on the basis of three key indicators: GDP per capita, life expectancy, and educational attainment. We've already seen that GDP is a highly misleading measure, so the UN's approach is far from perfect. It attaches no value to social equity, leisure time, and other important human goals.

Nevertheless, it is interesting to compare the ranking of countries according to human development, with their ranking according to GDP. In general, countries with high human development also have high levels of GDP per capita (partly because GDP is itself one of the three variables considered, and partly because higher GDP allows a society to devote more resources to health and education). This indicates that economic growth is indeed very important to standard of living.

However, the link between GDP and human development is not perfect. Some countries (such as the Nordic countries) rank higher in the UN list than they do on the basis of GDP alone. This indicates they are more efficient at translating GDP into genuine human welfare (usually thanks to extensive public services, financed with high taxes). On the other hand, countries which rank lower on the UN list than in the GDP standings are relatively ineffective at translating GDP into well-being; these countries (like the US and the UK) have relatively low taxes and relatively weak public programs.

Table 1.1 summarizes the key human development statistics for selected countries. High-tax Norway (where government spends over 50 percent of GDP on public programs) ranks first; low-tax America ranks eighth (despite having the second-highest GDP in the world). For each country, the difference between its GDP rank and its human development rank summarizes its success at translating GDP into genuine well-being; this difference is reported in the fourth column (shaded). A positive score in this column indicates that a country makes the most of its GDP; a negative score indicates the opposite. Socialist Cuba – where average health outcomes are superior to those in the US – manages to do more, given its GDP, to improve human welfare than any other country in the world. On the other hand, oil-rich Equatorial Guinea does the worst job of any country at channelling GDP into well-being. South Africa also has a very low human development ranking, despite its relatively advanced economy (by African standards), primarily because of low life expectancy and a very unequal distribution of income.

It's especially misguided to interpret GDP as a measure of human well-being. We've seen that there are many valuable things that are not included in GDP. On the other hand, many of the goods and services that *are* counted in GDP are utterly useless, annoying, or even destructive to human well-being – like dinner-hour telephone solicitations, many pharmaceuticals, excess consumer packaging, and armaments production. Moreover, just because a society produces more GDP never ensures that most members of society will ever receive a larger slice of that growing pie.

So we must be cautious in our use of GDP statistics, and we must never equate GDP with prosperity or well-being.

Despite these caveats, GDP is still an important and relevant measure. It indicates the value of all production that occurs for money. This is an important, appropriate piece of information for many purposes. (For example, the ability of governments to collect taxes depends directly on the money value of GDP.) We need to understand the weaknesses of GDP, and supplement it with other measures. Above all, we must remember that expanding GDP is never an end in itself. At best, properly managed, it can be a means to an end (the goal of improving human well-being). Indeed, there is a positive but imperfect relationship between GDP and human welfare (see box, p. 27). This suggests that we need to be concerned with how much we produce, but equally with what we use it for.

To be meaningful, GDP figures must take several additional factors into account. If the apparent value of our work grows purely because of INFLATION (which is a general increase in the prices of *all* goods and services), then there hasn't been any real improvement in the economy. Therefore we distinguish between NOMINAL GDP (measured in dollars/pounds) and REAL GDP (which deducts the effect of inflation). There are many other economic variables (such as wages and interest rates) for which this distinction between nominal and real values is also important. ECONOMIC GROWTH is usually measured by the expansion of real GDP.

In addition, a country's GDP could expand simply because its population was growing – but this does not imply that the country is becoming more prosperous. This is important when comparing growth rates across countries. For example, in countries with near-zero population growth (such as Europe and Japan), even a slow growth of real GDP can translate into improved living standards; this is not the case where population is growing more quickly. Therefore,

economists often divide GDP by population, to get a measure called **GDP PER CAPITA**. This, too, can be expressed in both nominal and real terms. Growth in real GDP per capita over time is often used as a rough indicator of prosperity – although we must always remember that GDP excludes many valuable types of work, and says nothing about how production is distributed.

What is a good economy?

Economics tries to explain how the economy works. But economists are equally (and justifiably) concerned with trying to make it work *better*. This inherently requires the economist (and every citizen) to make value judgements about what kind of economy is more desirable. Most economists, unfortunately, are not honest about those value judgements; they like to pretend that their profession is "scientific" and hence value-free, but this is a charade.

Deciding what economic goals to pursue will reflect the priorities and interests of different individuals, communities, and classes. It is an inherently subjective choice.

Here is my list of key economic goals. In my view, the more of these goals an economy achieves, the better it is:

1. **Prosperity** An economy should produce enough goods and services to support its citizens and allow them to enjoy life to the fullest. Prosperity does not just mean having more "stuff." It means enjoying a good balance between private consumption, public services, and leisure time. (Incidentally, leisure time is another valuable thing that doesn't appear in GDP statistics.)
2. **Security** The members of an economy should be confident that their economic conditions are reasonably stable. They shouldn't have to worry about being able to support themselves (so long as they work, if they're able), to keep their home, and to pass on decent economic opportunities to their children. The economic insecurity and turmoil experienced by billions of people today imposes real costs on them. Even people who may never lose their job or home spend a great deal of time and energy worrying that they might. That fear is costly. By the same token, economic security – being able to sleep at night without worrying about your livelihood – is valuable in its own right.

3. **Innovation** Economic progress requires us to think continuously about how to make our work more productive. This innovation includes imagining new goods and services (products), and better ways of producing them (processes). An economy should be organized in a way that promotes and facilitates innovative behaviour, or else it will eventually run out of creative energy and forward momentum.

4. **Choice** Individuals have different preferences, hopes, and dreams (although those preferences are strongly shaped by social pressures). They should have reasonable ability to make economic decisions – including the sort of work they do, where they live, and what they consume – in line with those preferences. There is a gigantic, ideological myth that only free-market economies truly respect individual "choice." This is obviously wrong: the choices of billions of human beings are brutally suppressed by the economic hardship and social divisions which are a natural outcome of global capitalism. Moreover, the services offered by the public sector (schools, health care, culture, parks) substantially expand the choices available to people (especially those with lower incomes). I accept that individual choice is an important economic goal – and I argue there are better ways to enhance true choice than through free-market capitalism.

5. **Equality** Inequality is harmful if it means that large numbers of people are deprived of the ability to work and enjoy their lives. In this sense, the goal of equality is bound up with the goal of prosperity (so long as we define "prosperity" correctly, as widespread well-being, rather than equating it with the growth of GDP). But I am also convinced that inequality is inherently negative in its own right. Even if those at the bottom of the economic spectrum still enjoyed some decent minimal standard of living, a concentration of wealth at the top will nevertheless undermine social cohesion, well-being, and democracy. For example, economists have identified a phenomenon called "positional consumption," by which people's emotional well-being is negatively influenced by unfavourable self-comparisons to the lifestyles of the rich and famous. When this occurs, inequality carries distinct negative consequences, quite apart from the consequences of poverty. To this end, limiting the economic distance between rich and poor is an important

economic goal. Equality also requires decent provisions to support those members of society who cannot work.

6. **Sustainability** Humans depend on their natural environment. It directly enhances our quality of life (through the air we breathe, and the spaces we inhabit). And it provides needed inputs that are essential to the work we do in every single industry. All production involves the application of human work to "add value" to something we got from nature. Maintaining the environment is important in its own right (all the more so if we accept that humans have some responsibility to the other species which inhabit our planet). It is also important in a more narrowly economic sense, since our ability to continue producing goods and services in the future will depend on finding sustainable ways to harvest (without continuously depleting or polluting) the natural inputs we need.
7. **Democracy and accountability** We've seen that the economy is an inherently social undertaking. Different people perform different functions. Some individuals and organizations have great decision-making power, while others have very little. How do we ensure that economic decisions, and the overall evolution of the economy, reflect our collective desires and preferences? And how do we monitor and ensure that people and institutions are doing the work they are supposed to? Modern capitalism has a well-developed but narrow notion of business accountability, through which corporations are compelled to maximize the wealth of their shareholders. Competitive markets also impose another narrow form of accountability, enforced through the threat of lost sales and ultimate bankruptcy for companies which produce shoddy or unduly expensive products. Democratic elections allow citizens to exert some influence (through their governments) over economic trends – although the ability of elected governments to manage a capitalist economy is fundamentally limited by the unelected power of businesses and investors. None of these limited forms of accountability provide for thorough or consistent ways of subjecting the economy to democratic control. Yet given the overarching importance of the economy to our general social condition, we are entitled to more genuine and far-reaching forms of economic democracy and accountability.

Is our present economy a good economy? In some ways, modern capitalism has done better than any previous arrangement in advancing each of these goals. In other ways, it fails my "good economy" test miserably. The rest of this book will endeavour to explain how the capitalist economy functions, the extent to which it meets (and fails to meet) these fundamental goals – and whether or not there are any better ways to do the job.

2

Capitalism

Capitalism: one kind of economy

This book focuses mostly on describing one very particular kind of economy: capitalism.

There, I've said it: the "C-word." Just mentioning that term sounds almost subversive, these days. Even talking about capitalism makes it sound like you're a dangerous radical of some kind. But we live in a capitalist economy, and we might as well name it. More importantly, we might as well understand what we are dealing with.

Curiously, even though capitalism dominates the world economy, the term "capitalism" is not commonly used. Even more curiously, this word is almost *never* used by economists. Neoclassical economics is dedicated to the study of capitalism; in fact, other kinds of economies (that existed in the past, or that may exist in the future) are not even contemplated. Yet the term "capitalism" does not appear in neoclassical economics textbooks.

Instead, economists refer simply to "the economy" – as if there is only one kind of economy, and hence no need to name or define it. This is wrong. As we have already seen, "the economy" is simply where people work to produce the things we need and want. There are different ways to organize that work. Capitalism is just one of them.

Human beings have existed on this planet for approximately 200,000 years. They had an economy all of this time. Humans have always had to work to meet the material needs of their survival (food, clothing, and shelter) – not to mention, when possible, to enjoy the "finer things" in life. Capitalism, in contrast, has existed for fewer than 300 years. If the entire history of *Homo sapiens* was a 24-hour day, then capitalism has existed for two minutes.

What we call "the economy" went through many different stages en route to capitalism. (We'll study more of this economic history in Chapter 3.) Even today, different kinds of economies exist. Some entire countries are non-capitalist. And within capitalist economies,

there are important non-capitalist parts (although most capitalist economies are becoming *more* capitalist as time goes by).

I think it's a pretty safe bet that human beings will eventually find other, better ways to organize work in the future – maybe sooner, maybe later. It's almost inconceivable that the major features of what we call "capitalism" will exist for the rest of human history (unless, of course, we drive ourselves to extinction in the near future through war, pollution, or other self-inflicted injuries).

So we shouldn't understand "the economy" and "capitalism" as identical. They are two different things. In this book we will study capitalism, as the dominant current form of economic organization. But we must always distinguish between what is *general* to all types of economy, and what is *specific* to capitalism.

What is capitalism?

There are two key features that make an economy capitalist.

1. Most production of goods and services is undertaken by privately-owned companies, which produce and sell their output in hopes of making a profit. This is called PRODUCTION FOR PROFIT.
2. Most work in the economy is performed by people who do not own their company or their output, but are hired by someone else to work in return for a money wage or salary. This is called WAGE LABOUR.

An economy in which private, profit-seeking companies undertake most production, and in which wage-earning employees do most of the work, is a capitalist economy. We will see that these twin features (profit-driven production and wage labour) create particular patterns and relationships, which in turn shape the overall functioning of capitalism as a system.

Any economy driven by these two features – production for profit and wage labour – tends to replicate the following trends and patterns, over and over again:

- Fierce *competition* between private companies over markets and profit.

- *Innovation*, as companies constantly experiment with new technologies, new products, and new forms of organization – in order to succeed in that competition.
- An inherent tendency to *growth*, resulting from the desire of each individual company to make more profit.
- Deep *inequality* between those who own successful companies, and the rest of society who do not own companies.
- A general *conflict* of interest between those who work for wages, and the employers who hire them.
- Economic *cycles* or "rollercoasters," with periods of strong growth followed by periods of stagnation or depression; sometimes these cycles even produce dramatic economic and social crises.

Some of these patterns and outcomes are positive, and help to explain why capitalism has been so successful. But some of these patterns and outcomes are negative, and explain why capitalism tends to be economically (and sometimes politically) unstable. The rest of this book will explain why these patterns develop under capitalism, and what (if anything) can be done to make the economy work better.

Capitalism began in Europe in the mid-1700s. Until then, these twin features – production for profit and wage labour – were rare. In pre-capitalist societies, most people worked for themselves, one way or another. Where people worked for someone else, that relationship was based on something other than monetary payment (like a sense of obligation, or the power of brute force). And most production occurred to meet some direct need or desire (for an individual, a community, or a government), not to generate a money profit.

Capitalism and markets

Even when economists bother to "name" the economy they are studying, they usually use a euphemism instead of the "C-word." They don't call it capitalism. They call it a "market economy." This implies that what is unique about capitalism is its reliance on markets and market signals (like supply, demand, and prices) to organize the economy. But that is wrong, too.

Markets of various kinds do indeed play a major role in capitalism. A market is simply a "place" where various buyers and sellers meet to haggle over price and agree on sales of a good, a service, or an asset. (By "place," I do not mean that a market has to have an actual physical location – it just needs to provide a way in which buyers and sellers can communicate and strike deals. In the internet era, markets can exist in cyberspace, not just at a community hall or stock exchange.)

Markets usually (but not always) imply some kind of competition, in which different buyers and sellers compete with each other to get the best deal. We will study the particular nature of competition under capitalism in detail in Chapter 11.

But capitalism is not the only economic system which relies on markets. Pre-capitalist economies also had markets – where producers could sell excess supplies of agricultural goods or handicrafts, and where exotic commodities (like spices or fabrics) from far-off lands could be purchased. Most forms of socialism also rely heavily on markets to distribute end products and even, in some cases, to organize investment and production. So markets are not unique to capitalism, and there is nothing inherently capitalist about a market.

Just as important, there are many aspects of modern capitalism that have nothing to do with markets. Within large companies, for example, very few decisions are made through market mechanisms. Instead, relationships of command, control, and plan reign supreme. (Remember, some corporations are economically larger than many countries, so these internal non-market relationships are important.) And there are other ways in which capitalism reflects powerful *non-market* forces and motivations – like tradition, habit, politeness, reciprocity, altruism, coercion, even (sometimes) brute force.

By pretending that capitalism is a system of "markets," economists imply that it is based on relationships between essentially equal parties. Neoclassical economists study two main kinds of markets: markets for FACTORS OF PRODUCTION (things that are used in production, like labour, land, and natural resources), and markets for the final GOODS and SERVICES produced with those factors. Neoclassical economists even describe the relationship between a large company and its workers as a form of market exchange. Everyone comes to the "market" with something to sell, and in theory they're all better off (than they were in the first place) as a result of trading in that marketplace.

Imagine a bustling bazaar, to represent the whole economy. In one corner of the hall is General Electric, which brings US$500 billion worth of capital assets to the market. In the other corner are some workers, with only their brains and brawn – their intelligence and their physical strength – to sell. Will a trade between these two sides be equal or voluntary, in any meaningful sense of those words? Not at all. And neoclassical economics doesn't bother explaining the historical process by which one stall at the bazaar is stocked with US$500 billion in capital, while another is stocked with just hard-working human bodies.

By pretending that capitalism is just a system of "markets," neoclassical economics deliberately blurs the real power relationships, and the often-violent historical processes, which explain the economic system we actually live in. Yes, we must study markets when we study capitalism – their flaws, as well as their virtues. But markets are not the idealized institutions portrayed in economics textbooks. And capitalism is equally shaped by other, non-market forces and structures, too.

So capitalism is not a "market economy." Capitalism is a system in which most production occurs for private profit, and most work is performed by wage labour.

Fads in capitalism

Of course, capitalism can change its "look" a lot, while still preserving its core, underlying features. Many economists and commentators have argued that capitalism today is not at all like capitalism in its early days (back in the soot and grime of the Industrial Revolution). These are some of the ways in which modern capitalism is supposedly a "new" system:

1. **The "post-industrial" economy** As discussed in Chapter 1, every economy produces both goods and services. Over time, a growing share of total value added in advanced capitalist countries consists of services. Today, services account for about 70 percent of GDP in advanced economies – and an even larger share, if we count non-traded output, like housework. The shrinking importance of goods is partly because technology and globalization have reduced their costs compared to services, and partly because most consumers prefer to buy a greater proportion of services (especially "luxuries"

such as restaurant meals and tourism) as their incomes rise. As large-scale industry becomes less important in the big economic picture, some economists argue that capitalism has changed, and that old stereotypes about "workers and bosses" no longer apply in this post-industrial system.

2. **The "information" economy** A related argument suggests that the advent of computer technology and the internet have created a fundamentally new economy – one centred on information, rather than commodities. Some pundits simply called this the "new economy." They even argued it would be immune to the traditional boom-and-bust cycles of earlier times. This theory was popular in the late 1990s, and helped to justify the ridiculous behaviour of internet-mad stock markets during this time. Beginning in 2000, however, the "dot-com" stock market boom collapsed (like all other stock market bubbles before it), and investors lost trillions of dollars. Since then, jargon about the "information economy" has become much less popular.

3. **The "shareholder" economy** Some observers have focused on the role played by pension funds, mutual funds, and other so-called "institutional" investors in modern stock markets. They argue that capitalism is fairer than it used to be, since more individuals now own shares and other forms of financial wealth (either directly, or indirectly through mutual and pension funds). They claim that this new "shareholder" system has somehow "solved" the age-old conflict between workers and capitalists.

There is a grain of truth in each of these portrayals – but only a grain. And in no case is it reasonable to conclude that capitalism has *fundamentally* changed.

Yes, services are increasingly important. But many services are produced in large-scale, factory-like workplaces. Think of a long-distance call centre, with hundreds of workers sitting in small cubicles, whose work is electronically paced and constantly monitored. And the services sector of the economy is still dominated (just like goods-producing industries) by profit-seeking private companies, many of them very large – and very profitable.

Yes, information is more important and faster-flowing than ever. But people cannot "eat" information; it is economically useful mostly as an input to other, more traditional goods and services industries.

And far from ushering in a new era of decentralization and supposed "participation," computer-related industries are still dominated by huge, profit-hungry companies (like Microsoft and Google).

Yes, pension and mutual funds are important players in stock markets. But the vast majority of financial wealth is still owned the old-fashioned way: by a surprisingly small elite of very wealthy families. In fact, in most capitalist countries financial wealth has become *more* concentrated among the rich, not less (we will discuss this in more detail in Chapter 7).

So while capitalism produces more services and less goods than it used to; while companies rely on sophisticated computer technology to manage their affairs; and while a significant proportion of households in the developed countries own *some* financial wealth (but not much, in the grand scheme of things), the core features of capitalism are still very much visible. Most production is undertaken by profit-seeking private companies. And most work is performed by people who do not own those companies, but who instead must work for wages. There is still incredible inequality, and an inherent conflict of interest, between the people who own successful companies, and the rest of us.

In short, there's nothing much "new" about capitalism at all.

3

Economic History

A short history of the economy

In the early days of human civilization, the "economy" was a pretty simple affair. Our work consisted of hunting animals for meat, fur, and bones; gathering wild produce (like berries); and constructing simple shelters. These hunter-gatherer economies were often nomadic (moving in tune with the weather or animal migrations). They were cooperative, in that everyone in a family or clan grouping worked together (with some division of tasks across genders and ages). And they were mostly non-hierarchical: no-one "owned" anything or "hired" anyone. (While priests, chiefs, or other leaders had special authority, that authority did not derive from their economic position.) In general, these economies produced just enough to keep their members alive from one year to the next.

Eventually humans learned they could deliberately cultivate useful plants, and agriculture began. This caused corresponding social and economic changes. First, it allowed for permanent settlements (with the opportunity to build better homes and other structures). Second, the greater productivity of agriculture allowed society to generate an economic SURPLUS: production beyond what was required just to keep the producers alive. Third, with that surplus came the task of deciding how to use it. The existence of a surplus allowed some members of society, for the first time, not to work. This opened up a whole new can of worms. Who would avoid working on the farm? What would they do instead? And how would they keep the rest of society – those who had to continue working – in line?

With permanent settlements and a growing economic surplus, therefore, came the first CLASS divisions within society – in which different groups of people fulfilled fundamentally different economic roles, depending on their status and their relationship to work. Different economic systems handled this fundamental issue in different ways. For example, under monarchist systems, a powerful elite controlled the surplus and its allocation based on inherited birthright. The monarch needed the acceptance or at least acquiescence of his

or her subjects, which generally needed to be imposed (from time to time, anyway) by brute force.

Many of these societies also relied on SLAVERY, where entire groups of people (often designated by race or caste) were simply forced to work, again through brute force. In case this sounds like ancient history, remember that the US economy (the most powerful capitalist country in the world) was based largely on slavery until fewer than 150 years ago, and human trafficking still forcibly enslaves millions of people around the world today. The resulting economic surplus was used in various ways: luxury consumption of the ruling elite; the construction of impressive buildings and monuments; the financing of exploration, war, and conquest; the work of non-agricultural artisans and scholars; and re-investment into new and improved economic techniques.

While slavery and direct authoritarian rule were certainly powerful and straightforward ways for elites to control the economy and the resulting surplus, they had their drawbacks, too. Slaves and subjects often revolted. Their work ethic was not always the best: slaves tend to be grudging and bitter (for obvious reasons), requiring "active supervision" (often with a whip!) to elicit their effort and productivity.

Eventually a more subtle and ultimately more effective economic system evolved, called FEUDALISM. In this case, a more complex web of mutual obligations and rights was used to organize work and manage the surplus. Peasants were allowed to live on land that was governed by a higher class (gentry, landlords, or royalty). They could support themselves and their families, but in return had to transfer most of their surplus production to the gentry (in the form of annual payments or tithes). The gentry used this surplus to finance their own (luxury) consumption, the construction of castles, the work of artisans and priests, maintenance of a simple state apparatus, wars, and other "fringe" activities. In return, they were supposed to protect the peasantry on their land (from attack by competing landlords), and ensure their security.

Agriculture became steadily more productive (with the invention of techniques such as crop rotation, the use of livestock, and plant breeding). The surplus became larger, allowing the development of more complex and ambitious non-agricultural activities – including the emergence of a more powerful and well-resourced central government, more ambitious non-agricultural production (including the emergence

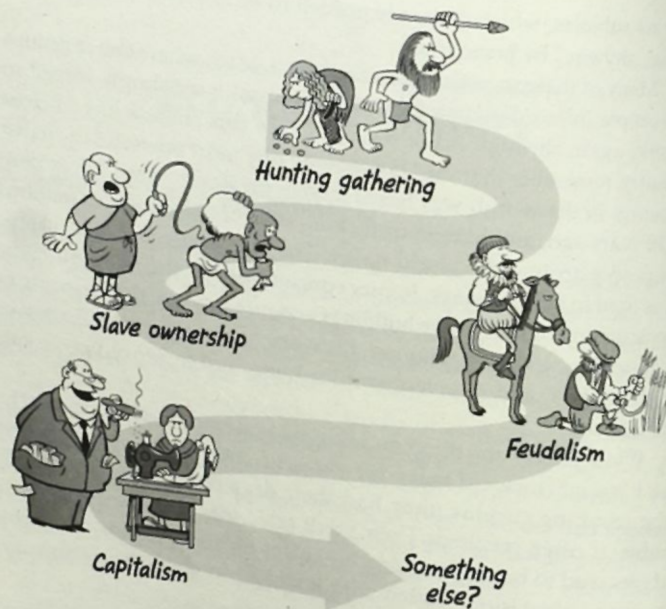

Figure 3.1 Economic Evolution

of early manufacturing workshops), and farther-reaching exploration and conquest. More effective transportation (like ocean-going ships) allowed the development of long-range trade (bringing in specialty goods from far-flung colonies and trading partners). Later in the Middle Ages, this trade sparked the emergence of a whole new class: merchants, who earned an often-lucrative slice of the surplus by facilitating this growing trade. These merchants would play an important transitional role in the subsequent development of capitalism.

This is a ridiculously short review of economic history. Yet it still conveys some crucial lessons that are relevant today:

- Human beings learn by doing. As they work at something for a while, they identify and implement ways to do it better. In economic terms, this leads to improvements in technology and productivity over time – sometimes very slowly, sometimes very quickly.

- These ongoing changes in productivity and technology tend to require corresponding changes in the way work is organized, and indeed in the way society is organized. The evolution of workplaces, class structure, markets, even politics has occurred hand-in-hand with the ongoing evolution of the economy.
- Economic systems come, and economic systems go. No economic system lasts forever. Capitalism is not likely to last forever, either.

Where did capitalism come from?

Capitalism first emerged in Western Europe, especially Britain, in the mid-1700s. It evolved from relatively advanced feudal monarchies, in which non-agricultural production and long-distance trade had become important economic activities, and in which central state power was relatively strong. Historians have spent a lot of time trying to determine the causes of this incredible economic and social transformation, and arguing about why it occurred in Europe instead of elsewhere in the world. (During the Middle Ages, China and India had been about as wealthy as Europe – but for various reasons, the social and technological changes which led to capitalism did not occur there.)

There is broad agreement on at least these key factors which contributed to the rise of capitalism:

- **New technology** The invention of steam power, semi-automated spinning and weaving machines, and other early industrial technologies dramatically increased productivity. Also, these technologies needed completely new ways of organizing work: in larger-scale factories which required more complex (and expensive) equipment. And they implied new structures of ownership: the machinery (and associated costs of raw materials and other necessary inputs) was too expensive for individuals or groups of workers to finance on their own. An owner was needed to finance the large up-front investments needed to get the factories working.
- **Empire** The fact that Britain (and, to a lesser extent, other European colonial powers) possessed the organizational and military ability to conquer and dominate far-off lands contributed

to the development of capitalism in many ways. It fostered the emergence of a class of merchants – which itself eventually evolved into a class of industrial capitalists. It provided raw materials and exotic goods, including the importation of cheap foodstuffs to feed the growing non-agricultural workforce. It extracted wealth from the colonies by brute force (including good old-fashioned slavery, in many instances) to support the growth of capitalism at home. It provided an inflow of precious metals to serve as money and lubricate commerce. And empire also provided captive markets for the impressive output of the new factories.

- **Government** In addition to the role of colonialism, the centralized state power that existed in Britain, France, and Holland was crucial to the emergence of capitalism. A strong government provided a reliable currency, standardization of commerce, and protection of the private property of the ambitious new capitalists. It could also help to keep peasants and workers in line, as they endured the painful shift from feudalism to capitalism. As we will discuss in Chapter 19, a strong central state was also crucial to the successful development of capitalism in subsequent countries, too (like America and Japan).
- **Resources** Conveniently, Britain had ample supplies of coal and iron needed for the new industries. Water-power in rural areas was also important in the early days of the Industrial Revolution. The availability of resources shouldn't be over-emphasized, however: many countries with abundant resources failed to develop quickly, while some countries (like Japan) successfully developed with very few resources.

The birth of capitalism was not pretty. Wages and conditions in the early factories were hellish. How did the first capitalists recruit workers? They were former peasants, driven off their former lands (which they never formally owned) by a process called the ENCLOSURES. Lands which were once held in common and worked under feudal rules were fenced in and assigned as formal private property to landlords – whose status became legal rather than traditional in nature. This also facilitated the depopulation of rural areas – necessary in light of the tremendous increases in the productivity of agriculture (far fewer farmers were needed to produce all the food the whole country

needed). In this way, capitalism produced two entirely new economic classes: a group of industrial capitalists who owned the new factories, and a group of workers who possessed nothing other than their ability to work in those factories.

The evolution of capitalism

The "birth" of capitalism, amidst the smoke and soot of the Industrial Revolution, was a painful and in many ways violent process. Workers were forced off their land and driven into cities, where they suffered horrendous exploitation and conditions that would be considered intolerable today: seven-day working weeks, twelve-hour working days, child labour, frequent injury, early death. Vast profits were earned by the new class of capitalists, most of which they ploughed back into new investment, technology, and growth – but some of which they used to finance their own luxurious consumption. The early capitalist societies were not at all democratic: the right to vote was limited to property owners, and basic rights to speak out and organize (including to organize unions) were routinely (and often violently) trampled.

Needless to say, this state of affairs was not socially sustainable. Working people and others fought hard for better conditions, a fairer share of the incredible wealth they were producing, and democratic rights. Under this pressure, capitalism evolved, unevenly, toward a more balanced and democratic system. Labour laws established minimum standards; unions won higher wages; governments became more active in regulating the economy and providing public services. But this progress was not "natural" or inevitable; it reflected decades of social struggle and conflict. And progress could be reversed if and when circumstances changed – such as during times of war or recession. Indeed, the history of capitalism has been dominated by a rollercoaster pattern of boom, followed by bust.

Perhaps the greatest bust of all, the Great Depression of the 1930s, spurred more changes. New banking regulations were aimed at preventing financial chaos. Government income-support and make-work projects tried to put people back to work. To some extent, these projects were influenced by the economic ideas of John Maynard Keynes (more on this in the next chapter). The greatest (and deadliest) make-work project was World War II. The war spurred massive

military spending which suddenly kicked all the major economies back into high gear, and eliminated unemployment.

After World War II, a unique set of circumstances combined to create the most vibrant and in many ways most optimistic chapter in the history of capitalism – what is now often called the "Golden Age." This postwar boom lasted for about three decades, during which wages and living standards in the developed capitalist world more than doubled. Strong business investment (motivated in part by postwar recovery and rebuilding) was reinforced by a rapid expansion of government spending in most capitalist economies. Unemployment was low, productivity grew rapidly, yet profits (initially at least) were strong. This was also the era of the "Cold War" between capitalism (led by the US) and communism (led by the former Soviet Union). In this context, business leaders and Western governments felt all the more pressure to accept demands for greater equality and security, since they were forced by global geopolitics to defend the virtues of the capitalist system.

Neoliberalism

It is now clear that beginning in the late 1970s, global capitalism entered a distinct and more aggressive phase. The previous willingness of business owners and governments to tolerate taxes, social programs, unions, and regulations petered out. Businesses and financial investors rebelled against shrinking profits, high inflation, militant workers, and international "instability" (represented most frighteningly by the success of left-wing revolutions in several countries in Asia, Africa, and Latin America in the 1970s). They began to agitate for a new, harder-line approach – and eventually they got it.

In retrospect, there were two clear "cannon shots" that signalled the beginning of this new chapter in the history of capitalism:

1. Paul Volcker became the head of the US Federal Reserve (the American CENTRAL BANK) in 1979. He implemented very strict MONETARY POLICY, heavily influenced by the ideas of Milton Friedman and the MONETARIST school (we'll discuss them more in Chapters 16 and 17). Interest rates rose dramatically, and economic growth slowed. Superficially, Volcker's high-interest-rate policy was motivated by a need to control and reduce inflation. But it quickly became clear that a deeper shift had occurred. Instead

of promoting full employment as their top priority (as during the Golden Age), central bankers would now focus on strictly controlling inflation, protecting financial assets, and keeping labour markets strictly in check.

2. Margaret Thatcher was elected as UK Prime Minister in 1979, followed by the election of Ronald Reagan as US President a year later. Both advocated an aggressive new approach to managing the economy (and all of society) in the interests of private business. They fully endorsed the hard-line taken by Volcker (and his counterparts in other countries). They were even tougher in attacking unions and undermining labour law and social policies (Reagan crushed the US air traffic controllers' union in 1981, while Thatcher defeated the strong British miners' union in 1985). Reagan and Thatcher shattered the broad Golden Age consensus, under which even conservative governments had accepted relatively generous social benefits and extensive government management of the economy. Despite forceful opposition in both countries, both leaders prevailed (supported by business interests), and became role models for hard-right conservatives in many other countries. Thatcher justified her initiatives with the now-classic (but false) slogan: "There is no alternative."

It gradually became clear that capitalism had fundamentally changed. The "kinder, gentler" improvements of the Golden Age era came under sustained attack, and would gradually (over the next quarter-century) be partially reversed – though not without a stubborn fightback by workers and communities. Some argued that capitalism could no longer afford those Golden Age programs; in my view, this is invalid, although there is no doubt that the Golden Age recipe began to encounter significant economic problems. Others argued that with the decline of communism and the weakening of left-wing parties, capitalism no longer *needed* to mollify its critics with compassionate policies (since it no longer faced a serious challenge to its continued existence).

This new era in capitalism has gone by several different names: neoconservativism, the "corporate agenda," and others. The most common term now used is **NEOLIBERALISM**. This term is confusing, since in some countries "liberal" refers to a centre or centre-left political ideology which still sees room for some Golden Age-style

policies. In economics, however, "liberal" means something quite different: it means *an absence of government interference*. In this sense, "neoliberalism" implies going back to a more rough-and-tumble kind of capitalism, in which governments play a smaller role in regulating the economy and protecting social interests. But even this definition is not quite accurate: in fact, there are still many ways in which government and the state continue to wield real economic power under neoliberal capitalism (we will discuss these in later chapters). What has changed is *how*, and in *whose interests*, that power is now exercised.

Table 3.1 **Key Goals and Tools of Neoliberalism**

***Key Goals*:**

- Reduce and control inflation; protect the value of financial wealth
- Restore insecurity and "discipline" to labour markets
- Eliminate "entitlements"; force families to fend for themselves
- Roll back and refocus government activities to meet business needs; cut taxes
- Generally restore the economic and social dominance of private business and wealth
- Claw back expectations; foster a sense of resignation to insecurity and hardship

***Key Tools*:**

- Use interest rates aggressively to regulate inflation and control labour markets
- Privatize and deregulate more industries
- Scale back social security programs (especially for working-age adults)
- Deregulate labour markets (including attacks on unions)
- Use free-trade agreements to expand markets and constrain government interventions

The main goals of neoliberalism, and the tools used to achieve those goals, are listed in Table 3.1. They include controlling inflation; disciplining labour; downsizing and focusing government; and reinforcing business leadership. The broadest but perhaps most important goal is the last one listed in the first part of Table 3.1: ratcheting down popular expectations. There has been a deliberate and multidimensional effort since the early 1980s to construct a whole new cultural mindset, in which people stop demanding much from the economy, and accept insecurity and vulnerability as permanent, "natural" features of life. In the 1970s workers in most capitalist countries were uppity and feisty, ready to demand a better deal from their employers and their society. Today, after a quarter-century of neoliberalism, many are tempted to bow down in thanks that they

at least have a job. Overturning this passive, defeatist mindset will be crucial for motivating people to challenge the inequality and imbalance that typify our economy today.

Kinds of capitalism

Even under neoliberalism, however, and despite the pressures for conformity that arise from globalization, there are still clear differences between capitalist economies – even those at similar levels of development. (There are even bigger differences, of course, between richer capitalist countries and poor ones.) So it would be a dangerous mistake to imply that all capitalist economies must now follow exactly the same set of policies. And those differences produce very different outcomes for the people who live and work in those economies.

Table 3.2 identifies four broad "types" of capitalism among the most developed countries in the world. They operate very differently in terms of how harshly workers are treated, how economically active government is, and the sectoral make-up of the economy. The "Anglo-Saxon" variant of capitalism is, by most indicators, the most unequal of all. It is characterized by a small role for government, an overdeveloped financial sector, and the largest inequalities in income. Other variants of capitalism – like the Nordic, the continental, or the Asian variants – offer generally better outcomes for working people.

Clearly, different societies still have considerable leeway to put their own stamp on the economy, even when the fundamental rules and structures of capitalism remain in place. Working for incremental improvements in capitalism, making it a little bit fairer and less degrading, is clearly important.

After capitalism?

At the same time as we fight for positive reforms in capitalism, we may also want to consider whether it's possible to move *beyond* the fundamental rules and structures of the system. After all, capitalism represents just one phase (and a relatively short phase, so far) in the evolution of human economic activity. That long process of evolution is not going to suddenly stop. We haven't arrived at some kind of economic "nirvana": a perfect system which can't possibly be improved. Collectively, we will continue developing new technologies, new goods and services, and new ways of organizing work. And it is

Table 3.2 Types of Capitalism (in the advanced countries)

Type of Capitalism	*Role of Government: Taxes as Share GDP*	*Role of Government: Economic Regulation*	*Financial Sector (Banks, Stock Market)*	*Income Distribution*	*Managing Income Distribution*	*Union Coverage as % Workforce*
Anglo-Saxon (US, UK, Canada, Australia)	30–35%	Weak	Very Large	Very Unequal	Market Power	10–30%
Continental (France, Germany, Italy)	35–45%	Moderate	Moderate	Somewhat Equal	Mild Corporatist†	20–50%
Asian (Japan, Korea, soon China)	25–35%	Strong	Relatively Small	Somewhat Equal	Paternalist Corporatist†	20–30%
Nordic (Sweden, Denmark, others*)	45–55%	Strong	Relatively Small	Very Equal	Strong Corporatist†	50–80%

* Some other European countries (like Austria and the Netherlands) have features similar to the Nordic type.
† CORPORATISM refers to a system of centralized negotiation between business, labour, and government.

almost certain that we will ultimately find new forms of ownership, and new forms of economic management, to make the most of those new tools – and, hopefully, to do a better job of meeting our human and environmental needs in the process. Sooner or later, I suspect we'll end up with something quite different from capitalism: some system in which most production is no longer undertaken by private, profit-seeking companies, and most work is no longer undertaken solely in return for a money wage.

The world has some experience with "life after capitalism," but that experience has been difficult and in most cases unsuccessful. Communist-led economies were built in Eastern Europe, China, and some developing countries in the mid-twentieth century; most of these failed in the face of economic stagnation and/or political breakdown. A few countries (like Cuba) have tried to preserve aspects of that system, and others (like Venezuela) are trying to build new forms of socialism. Successful smaller-scale experiments in non-capitalist economic development have taken place in parts of other countries – like the Basque region of Spain, or the Indian state of Kerala.

We will discuss the problems and prospects of post-capitalist society in the last part of this book. We don't know what will come after capitalism, or when or how it will happen. But it would be folly to expect capitalism to last forever.

4

The Politics of Economics

Early economics

In earlier eras, human economic activity was pretty straightforward. You worked hard to produce the things you needed to survive. Powerful people (slave owners or feudal lords) took some of what you produced. You kept what was left. End of story.

As the economy became more complex, however, the relationships between different economic players became more indirect and harder to decipher. Economics was born, as the social science which aimed to explain those increasingly complex links. The first economists were called "political economists," in recognition of the close ties between economics and politics. They began to theorize about the nature of work, production, value, and growth just as Europe's economy was evolving from feudalism toward capitalism.

The first identifiable school of economics were the MERCANTILISTS, based mostly in Britain in the 1600s. Their theories paralleled the growing economic power of the British empire, so not surprisingly they emphasized the importance of international trade to national economic development. In particular, they believed that a country's national wealth would grow if it generated large trade surpluses: that is, if it exported more than it imported. Mercantilists were also forceful advocates of strong central government, in part to strengthen colonial power and hence boost the trade surplus. Even today, the mercantilist spirit lives on (in modified form) in modern-day theories of "export-led growth" – such as those followed in recent years by the industrializing countries of Asia.

Across the English Channel and a century later, a group of French thinkers called the PHYSIOCRATS developed a very different approach to economics – one that also lives on in modern economics. They focused on the relationship between agricultural and non-agricultural industries (such as early artisans and workshops), and traced the flow of money between those different sectors. They likened this flow to the circulation of blood through the human body; indeed, the most famous Physiocrat was François Quesnay, a physician

to the French king. Their early efforts to trace the relationships between different sectors of the economy inspired modern theories of monetary circulation (which we will consider in Part Four). And they were the first school of economics to analyze the economy in terms of CLASS.

Adam Smith is often viewed as the "father" of free-market economics, but this stereotype is not quite accurate. Nevertheless, his famous *Wealth of Nations* (published in 1776, the same year as American independence) came to symbolize (like America itself) the dynamism and opportunity of capitalism. Smith identified the productivity gains from large-scale factory production and its more intensive division of labour (whereby different workers or groups of workers perform a variety of very specialized tasks). To support this new system, he advocated deregulation of markets, the expansion of trade, and policies to protect the profits and property rights of the early capitalists (who Smith celebrated as virtuous innovators and accumulators). He argued that free-market forces (which he called the "invisible hand") and the pursuit of self-interest would best stimulate innovation and growth. However, his social analysis (building on the Physiocrats) was rooted more in *class* than in individuals: he favoured policies to undermine the vested interests of rural landlords (who he thought were unproductive) in favour of the more dynamic new class of capitalists.

Defunct Economists

"The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist."

John Maynard Keynes, British economist (1936).

Smith's work founded what is now known as CLASSICAL ECONOMICS. This school of thought focused on the dynamic processes of growth and change in capitalism, and analyzed the often conflictual relationship between different classes. In general, classical economists accepted the idea that the value of a product was determined by the amount

of work required to produce it (what became known as the "labour theory of value"). After Smith, the most famous classical theorists were David Ricardo and Thomas Malthus. Ricardo developed a hugely influential theory of free trade known as COMPARATIVE ADVANTAGE. It claims that every country will be better off through free trade, even if *all* its industries are inefficient. (The theory is true, but only under very restrictive assumptions; we'll discuss it further in Chapter 21.) Meanwhile, Ricardo's friend Thomas Malthus developed an infamous theory of population growth which justified keeping wages very low. He argued that if wages were raised above bare subsistence levels, workers would simply procreate until their growing population absorbed all the new income. Therefore, wages should naturally settle at subsistence levels. Malthus was dead wrong: in fact, birth rates *decline* as living standards improve. Nevertheless, the classical economists (and Karl Marx after them) did accept the broad idea that workers' wages tended to stagnate in the long term (rather than rising automatically with economic growth).

Needless to say, the oppressive working and living conditions of the Industrial Revolution, and the glaring contrast between the poverty of the new working class and the wealth of the new capitalist class, sparked abundant economic and political turmoil. Workers formed unions and political parties to fight for a better deal, often encountering violent responses from employers and governments. An economic underpinning for this fightback was provided by Karl Marx. Like the classical economists, he focused on the dynamic evolution of capitalism as a system, and the turbulent relationships between different classes. He argued that the payment of profit on private investments did not reflect any particular economic function, but was only a *social* relationship. Profit represented a new, more subtle form of EXPLOITATION: an indirect, effective way of capturing economic surplus from those (the workers) who truly do the work. Marx tried (unsuccessfully) to explain how prices in capitalism (which include the payment of profit) could still be based on the underlying labour values of different commodities. And he predicted the ultimate breakdown of capitalism, in the face of both economic instability (the ongoing boom-and-bust cycle) and political resistance. Marx's ideas were very influential in the later development of labour and socialist movements around the world.

Neoclassical economics

After Marx, the capitalist economies of Europe continued to be disrupted by regular interludes of revolutionary fervour. Gradual economic and political reforms were achieved through the nineteenth century in response to these upheavals: limited social programs and union rights were introduced to moderate the worst inequalities of industry, and democracy was gradually expanded (at first, workers were not allowed to vote since they didn't own property). And it was in this context that a whole new school of economics arose.

Following an especially strident wave of revolutionary struggles in Europe (including the first attempt to establish a socialist society in Paris in 1871), NEOCLASSICAL ECONOMICS strove to justify the economic efficiency and moral superiority of the capitalist (or "free market") system. The neoclassical pioneers included Léon Walras (in Switzerland), Carl Menger (in Austria), and Stanley Jevons (in Britain); Walras was ultimately the most influential.

These theorists seemed to start from the precepts of their market-friendly classical predecessors (in fact, "neoclassical" simply means "new classical"), but in fact they made important changes to the classical approach. First, they focused on individuals, not classes. Second, they focused on the existence of market EQUILIBRIUM at any particular point in time – like a snapshot of the economy – rather than on the evolution and development of an economy over time. Third, they began to apply mathematical techniques to economic questions. And they adopted a more abstract approach to theory: instead of explaining concrete, visible realities in the economy, neoclassical theory uses abstract logic to build complex economic theories on the basis of a few starting assumptions, or "axioms."

Neoclassical theory still dominates the teaching of economics in developed countries, although there are many cracks in its walls. The key premises of the neoclassical approach include:

- Every individual starts life with some initial "endowment" of one or more of the FACTORS OF PRODUCTION (labour power, skill, wealth, or other resources). The theory does not concern itself with explaining how that initial endowment came about.
- Every individual also has a set of PREFERENCES which determine what goods and services they like to consume. Again, the

theory does not concern itself with explaining how those preferences evolve.

- Technology determines how those various factors of production can be converted into useable goods and services, through the process of production. Initially, neoclassical theory did not try to explain technology; more recent neoclassical writers have begun to study how and why technology evolves.
- Through extensive market trading (in both factors of production and produced goods and services), the economic system will ensure that all factors of production are used (including all labour being employed) in a manner which best satisfies the preferences of consumers. Important and unrealistic assumptions about the nature of markets and competition are required to reach this optimal resting point – a market-determined economic nirvana.

If supply equals demand in all markets (both factors of production and final goods and services), then the system is considered to be in GENERAL EQUILIBRIUM. Walras was the first to describe this situation, and the theory came to be known as *Walrasian general equilibrium*. Modern neoclassical thinkers have tried to prove mathematically that this general equilibrium is in fact possible; they have failed repeatedly, and today general equilibrium theory has fallen out of favour with many academic economists. Even in theory, the model depends on incredibly extreme and unrealistic assumptions (regarding perfect competition, perfect information, and perfect rationality). The theory has almost no practical applications. Nevertheless, the policy conclusions of the Walrasian view remain very influential, even though their logical underpinning is weak. Here are the key neoclassical conclusions:

- Left to its own devices, the economy will settle at a position of full employment, in which all potential economic resources (including labour) are used efficiently. For this reason, the economy is SUPPLY-CONSTRAINED: only the supply of productive factors limits what the economy can produce.
- This works best when private markets are allowed maximum leeway to operate. Attempts to regulate market outcomes (such

as by imposing minimum wages or taxes) will reduce economic well-being by interfering with market forces. Governments should limit their role to providing essential infrastructure and protecting private property rights.

- Expanding trade (including international trade) will always expand the total economic pie, and this creates the *potential* for improving the economic outcomes of everyone in society.
- The profit received by investors reflects the real "productivity" of the capital that they own, and hence profit is both legitimate and economically efficient. Proving that profit is economically and morally justifiable, rather than the result of exploitation, has been a central preoccupation of neoclassical economics.

Economics after Keynes

The development of neoclassical theory reflected the debates and conflicts of industrial capitalism. The capitalist economy continued to develop through the nineteenth and twentieth centuries in fits and starts, with periods of vibrant growth interspersed with periods of sustained stagnation and recession. But with the Great Depression of the 1930s, it became very obvious that neoclassical faith in the economy's self-adjusting, full-employment equilibrium was painfully misplaced. In reality, capitalism was visibly unable to ensure that all resources (especially labour) were indeed employed.

A new era of thinkers arose to explain both the failure of capitalism to employ labour, and advise what could be done about it. The most famous was John Maynard Keynes, who worked in Britain between the two world wars. Just as important but lesser known was Michal Kalecki, who was born in Poland but also worked in Britain. Working separately, they developed (at about the same time) the theory of EFFECTIVE DEMAND. In general, they found, an economy's output and employment were not limited only by the supply of productive factors (as believed in neoclassical theory). The economy can also be DEMAND-CONSTRAINED by the strength of aggregate purchasing power. If purchasing power is weak for some reason (due to financial or banking problems, pessimism among consumers or investors, or other factors), then unemployment will exist. Worse yet, there is no natural tendency for that unemployment to resolve itself.

To deal with this problem, Keynes advocated proactive government policies to adjust taxes, government spending, and interest rates in order to attain full employment. Kalecki went further than Keynes, and showed that effective demand conditions also depend on the distribution of income (and the distribution of power) between classes; he advocated socialism as the ultimate solution to the problem of unemployment.

As it turned out, massive government military spending during World War II did indeed "solve" the Great Depression. Then, during the vibrant postwar expansion that followed, neoclassical economics uncomfortably tried to digest a watered-down version of Keynesian ideas. The leading economists of this era (such as America's Paul Samuelson and Britain's John Hicks) tried to construct a "synthesis" of neoclassical and Keynesian approaches. They concluded that unemployment and depression could only occur under very particular conditions. In most cases, however, they felt that the basic neoclassical model was still valid.

Eventually even this limited departure from key neoclassical commandments was abandoned. Global capitalism experienced growing instability and stagnation in the 1970s, as the Golden Age drew to a close. A new group of hard-nosed neoclassical thinkers – led by Milton Friedman and his colleagues at the University of Chicago – attributed this instability to misplaced government intervention. They resuscitated the core neoclassical policy framework (according to which government should provide a stable, market-friendly environment, and do nothing else), and hence provided the intellectual foundation for neoliberalism. This approach has become dominant in economics in most countries.

There is still much debate and controversy within economics today – although not nearly as much as there should be. In particular, economics instruction in English-speaking countries conforms quite narrowly to neoclassical doctrine.

Some economists, however, reject neoclassical assumptions and methodology. For example, **Post-Keynesians** have worked to develop the more non-neoclassical aspects of Keynes' work – emphasizing the economic importance of uncertainty and the particular nature of money. (Keynes himself never fundamentally broke from neoclassical thinking, and this has caused great confusion and controversy in subsequent years about what he "really" meant.) Other economists, known as radical or **structuralist** thinkers, have branched out from

Kalecki's work, emphasizing the connections between power, class, demand, and growth. Some economists continue to work within the Marxist tradition, and others in a broad stream of thought known as INSTITUTIONALIST economics (which emphasizes the evolution of economic and social institutions).

It will be essential in coming years to nurture these various "heterodox" streams within economics ("heterodox" refers here to any economist who breaks away from neoclassical orthodoxy), in order to provide some badly-needed diversity and balance within the profession.

Impure Science

"Economics has three functions – to try to understand how an economy operates, to make proposals for improving it, and to justify the criterion by which improvement is judged. The criterion of what is desirable necessarily involves moral and political judgements. Economics can never be a perfectly 'pure' science, unmixed with human values."

Joan Robinson and John Eatwell, British economists (1973).

The economy, economics, and politics

This extremely condensed history of economics reveals a couple of important lessons:

- The development of economics has paralleled the development of the economy itself. Economists have tried to keep up with real-world economic problems, challenges, and conflicts. The theories of some economists have supported those seeking to change the economy; the theories of others have justified the status quo.
- Consequently, economics is not a "pure" science; it never has been. Economists have worked to try to understand the economy and how it functions. But they have also had views – usually very strong ones, and often hidden – about how the economy *should* function. In the jargon of economics, the pure study of the economy is called "positive" economics; it is supposed

Table 4.1 Economics and Politics Through the Ages

Theory	*Time*	*Economic Context*	*Political Context*
Mercantilists	Seventeenth century	Expansion of European colonial empires	Support for centralized state political and military power
Physiocrats	Early eighteenth century	Expansion of non-agricultural industries	Defend agricultural surplus against undue expropriation
Classical	Late eighteenth century, early nineteenth century	Birth of industrial capitalism	Favour ascendant capitalists over landlords; promote expansion of markets
Marx	Mid-nineteenth century	Consolidation, expansion of capitalism	Explain and criticize exploitation of workers; describe socialist alternative
Neoclassical	Late nineteenth century, early twentieth century	Consolidation, expansion of capitalism; democratic and social reforms	Reaction against European revolutions; provide justification for private profit
Keynes/ Kalecki	Post-1930s	Great Depression; WWII; advent of "Golden Age"	Policies to restore full employment, expand social security
Monetarism, neoclassical resurgence	1970s to today	Breakdown of "Golden Age"	Describe failure of "Golden Age" policies; intellectual justification for neoliberalism
Modern heterodox*	Today	Consolidation of neoliberalism	Describe failures of neoliberalism; advance alternative policies

* Includes Post-Keynesian, structuralist, institutionalist, Marxian.

to be separate from the advocacy of particular policies, called "normative" economics. But in practice, these two functions get mixed up all the time.

- The theories of economists have always been spurred by real world debates, politics, and interests (see Table 4.1). The Mercantilists celebrated the power and reach of empire. The Physiocrats tried to protect farmers against undue expropriation of their produce. The classical writers were concerned to celebrate (and hence justify) the innovative and growth-inducing

behaviour of the new capitalist class. Marx's analysis of conflicts in capitalism was tied up with his vision of radical political change. Early neoclassical economics justified the payment of private profit and the dominance of markets. Keynes grappled with the destruction and lost potential of the Depression, while the subsequent resurgence of neoclassical doctrines both reflected and assisted the parallel reassertion of private-sector power under neoliberalism.

Today, economics continues to display its inherently political character. There is no economic policy debate which does not involve trade-offs and conflicting interests; discussions of economic "efficiency" and "rationalism" are therefore never neutral. When a blue-suited bank economist appears on TV to interpret the latest GDP numbers, the reporter never mentions that this "expert" is ultimately paid to enhance the wealth of the shareholders of the bank. (On the rare occasions when a *union* economist is interviewed, the bias is usually presumed, by both the reporter and the audience, to be closer to the surface.)

And when economists invoke seemingly scientific and neutral terms like "efficiency," "growth," and "productivity," we must always ask: "Efficiency for whom? What kind of growth? And who will reap the benefits of productivity?"