Modern Politics

Capitalism & Neo-Liberalism

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What Is Capitalism?

Sarwat Jahan and Ahmed Saber Mahmud

CAPITALISM is often thought of as an economic system in which private actors own and control property in accord with their interests, and demand and supply freely set prices in markets in a way that can serve the best interests of society.

The essential feature of capitalism is the motive to make a profit. As Adam Smith, the 18th century philosopher and father of modern economics, said: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." Both parties to a voluntary exchange transaction have their own interest in the outcome, but neither can obtain what he or she wants without addressing what the other wants. It is this rational self-interest that can lead to economic prosperity.

In a capitalist economy, capital assets—such as factories, mines, and railroads—can be privately owned and controlled, labor is purchased for money wages, capital gains accrue to private owners, and prices allocate capital and labor between competing uses (see "Supply and Demand," p. 12).

Although some form of capitalism is the basis for nearly all economies today, for much of the past century it was but one of two major approaches to economic organization. In the other, *socialism*, the state owns the means of production, and state-owned enterprises seek to maximize social good rather than profits.

Pillars of capitalism

Capitalism is founded on the following pillars:

- private property, which allows people to own tangible assets such as land and houses and intangible assets such as stocks and bonds;
- self-interest, through which people act in pursuit of their own good, without regard for sociopolitical pressure. Nonetheless, these uncoordinated individuals end up benefiting society as if, in the words of Smith's 1776 *Wealth of Nations*, they were guided by an invisible hand;
- competition, through firms' freedom to enter and exit markets, maximizes social welfare, that is, the joint welfare of both producers and consumers;
- a market mechanism that determines prices in a decentralized manner through interactions between buyers and sellers—prices, in return, allocate resources, which naturally seek the highest reward, not only for goods and services but for wages as well;
- freedom to choose with respect to consumption, production, and investment—dissatisfied customers can buy different products, investors can pursue more lucrative ventures, workers can leave their jobs for better pay; and
- limited role of government, to protect the rights of private citizens and maintain an orderly environment that facilitates proper functioning of markets.

The extent to which these pillars operate distinguishes various forms of capitalism. In free markets, also called laissez-faire economies, markets operate with little or no regulation. In *mixed economies*, so called because of the blend of markets and government, markets play a dominant role, but are regulated to a greater extent by government to correct market failures, such as pollution and traffic congestion; promote social welfare; and for other reasons, such as defense and public safety. Mixed capitalist economies predominate today.

The many shades of capitalism

Economists classify capitalism into different groups using various criteria. Capitalism, for example, can be simply sliced into two types, based on how production is organized. In *liberal market economies*, the competitive market is prevalent and the bulk of the production process takes place in a decentralized manner akin to the free-market capitalism seen in the United States and the United Kingdom. *Coordinated market economies*, on the other hand, exchange private information through non-market institutions such as unions and business associations—as in Germany and Japan (Hall and Soskice 2001).

More recently, economists have identified four types of capitalism distinguished according to the role of entrepreneurship(the process of starting businesses) in driving innovation andthe institutional setting in which new ideas are put into place to spur economic growth (Baumol, Litan, and Schramm 2007).In *state-guided capitalism*, the government decides which sec- tors will grow. Initially motivated by a desire to foster growth,this type of capitalism has several pitfalls: excessive investment, picking the wrong winners, susceptibility to corruption, anddifficulty withdrawing support when it is no longer appropriateate. *Oligarchic capitalism* is oriented toward protecting and

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ng a very narrow fraction of the population. Economic ...h is not a central objective, and countries with this variety have ...at deal of inequality and corruption.

Big-firm capitalism takes advantage of economies of scale. This type is important for mass production of products. *Entrepreneurial capitalism* produces breakthroughs like the automobile, telephone, and computer. These innovations are usually the product of individuals and new firms. However, it takes big firms to mass-produce and market new products, so a mix of big-firm and entrepreneurial capitalism seems best. This is the kind that characterizes the United States more than any other country.

The Keynesian critique

During the Great Depression of the 1930s, the advanced capitalist economies suffered widespread unemployment. Inhis 1936 *General Theory of Employment, Interest, and Money*, British economist John Maynard Keynes argued that capitalism struggles to recover from slowdowns in investment because a capitalist economy can remain indefinitely in equilibrium with high unemployment and no growth. Keynesian economics challenged the notion that laissez-faire capitalist economies could operate well on their own without state intervention to promote aggregate demand and fight high unemployment and deflation of the sort seen during the 1930s. He postulated that government intervention (by cutting taxes and increasing government spending) was needed to pull the economy out of the recession (see "What Is Keynesian Economics?" p. 4). These actions sought to temper the boom and bust of the business cycle and to help capitalism recover following the Great Depression. Keynes never intended to replace the market-based economy with a different one; he asserted only that periodic government intervention was necessary.

The forces that generally lead to the success of capitalism can also usher in its failure. Free markets can flourish only when governments set the rules that govern them—such as laws that ensure property rights—and support markets with proper infrastructure, such as roads and highways to move goods and people. Governments, however, may be influenced by organized private interests that try to leverage the power of regulations to protect their economic position at the expenseof the public interest—for example, by repressing the same free market that bred their success.

Thus, according to Rajan and Zingales (2003), society must "save capitalism from the capitalists"—that is, take appropriate steps to protect the free market from powerful private interests that seek to impede its efficient functioning. When political interest and the capitalist class combine, "crony capitalism" may emerge, and nepotism will be more rewarding than efficiency. The concentration of ownership of productive assets must be limited to ensure competition. And, because competition begets winners and losers, losers must be compensated. ... trade and strong competitive pressure on incumbent firms ... also keep powerful interests at bay. The public needs to see ... virtues of free markets and oppose government interventi... in the market to protect powerful incumbents at the expens... of overall economic prosperity.

The essential feature of capitalism is the motive to make a profit.

Economic growth under capitalism may have far surpassed that of other economic systems, but *inequality* remains one of its most controversial attributes. Do the dynamics of private capital accumulation inevitably lead to the concentration of wealth in fewer hands, or do the balancing forces of growth, competition, and technological progress reduce inequality? Economists have taken various approaches to finding the driver of economic inequality. The most recent study analyzes a unique collection of data going back to the 18th century to uncover key economic and social patterns (Piketty 2014). It finds that in contemporary market economies, the rate of return on investment frequently outstrips overall growth. With compounding, if that discrepancy persists, the wealth held by owners of capital will increase far more rapidly than other kinds of earnings (wages, for example), eventually outstripping them by a wide margin. Although this study has as many critics as admirers, it has added to the debate on wealth distribution in capitalism and reinforced the belief among many that a capitalist economy must be steered in the right direction by government policies and the general public to ensure that Smith's invisible hand continues to work in society's favor. FD

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What is Neoliberalism?

Elizabeth Martinez and Arnoldo Garcia

"Neo-liberalism" is a set of economic policies that have become widespread during the last 25 years or so. Although the word is rarely heard in the United States, you can clearly see the effects of neo-liberalism here as the rich grow richer and the poor grow poorer.

"Liberalism" can refer to political, economic, or even religious ideas. In the U.S. political liberalism has been a strategy to prevent social conflict. It is presented to poor and working people as progressive compared to conservative or Rightwing. Economic liberalism is different. Conservative politicians who say they hate "liberals" -- meaning the political type -- have no real problem with economic liberalism, including neoliberalism.

"Neo" means we are talking about a new kind of liberalism. So what was the old kind? The liberal school of economics became famous in Europe when Adam Smith, an Scottish economist, published a book in 1776 called THE WEALTH OF NATIONS. He and others advocated the abolition of government intervention in economic matters. No restrictions on manufacturing, no barriers to commerce, no tariffs, he said; free trade was the best way for a nation's economy to develop. Such ideas were "liberal" in the sense of no controls. This application of individualism encouraged "free" enterprise," "free" competition -- which came to mean, free for the capitalists to make huge profits as they wished.

Economic liberalism prevailed in the United States through the 1800s and early 1900s. Then the Great Depression of the 1930s led an economist named John Maynard Keynes to a theory that challenged liberalism as the best policy for capitalists. He said, in essence, that full employment is necessary for capitalism to grow and it can be achieved only if governments and central banks intervene to increase employment. These ideas had much influence on President Roosevelt's New Deal -- which did improve life for many people. The belief that government should advance the common good became widely accepted.

But the capitalist crisis over the last 25 years, with its shrinking profit rates, inspired the corporate elite to revive economic liberalism. That's what makes it "neo" or new. Now, with the rapid globalization of the capitalist economy, we are seeing neo-liberalism on a global scale.

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The main points of neo-liberalism include:

1. **THE RULE OF THE MARKET.** Liberating "free" enterprise or private enterprise from any bonds imposed by the government (the state) no matter how much social damage this causes. Greater openness to international trade and investment, as in NAFTA. Reduce wages by de-unionizing workers and eliminating workers' rights that had been won over many years of struggle. No more price controls. All in all, total freedom of movement for capital, goods and services. To convince us this is good for us, they say "an unregulated market is the best way to increase economic growth, which will ultimately benefit everyone." It's like Reagan's "supply-side" and "trickle-down" economics -- but somehow the wealth didn't trickle down very much.

2. **CUTTING PUBLIC EXPENDITURE FOR SOCIAL SERVICES** like education and health care. REDUCING THE SAFETY-NET FOR THE POOR, and even maintenance of roads, bridges, water supply -- again in the name of reducing government's role. Of course, they don't oppose government subsidies and tax benefits for business.

3. **DEREGULATION.** Reduce government regulation of everything that could diminsh profits, including protecting the environment and safety on the job.

4. **PRIVATIZATION.** Sell state-owned enterprises, goods and services to private investors. This includes banks, key industries, railroads, toll highways, electricity, schools, hospitals and even fresh water. Although usually done in the name of greater efficiency, which is often needed, privatization has mainly had the effect of concentrating wealth even more in a few hands and making the public pay even more for its needs.

5. **ELIMINATING THE CONCEPT OF "THE PUBLIC GOOD" or "COMMUNITY"** *and replacing it with* "individual responsibility." *Pressuring* the *poorest people in a* society to find solutions to their lack of health care, education *and social security* all by themselves -- then blaming them, if they fail, as "lazy."

Austerity

Deunion~~ization~~

The rise and fall of neoliberalism

Neoliberalism is increasingly being blamed for varied problems plaguing the modern world. The East Asian Crisis during the late 1990s, and the global crisis of 2007-08 triggered by the US housing market collapse, are both attributed to neoliberal excesses. The growing disparity between the rich and the poor, including the offshoring rather than the trickling down of wealth, are also considered to have been instigated, or at least, worsened by neoliberal policies. Even the crumbling state of public services, and the massive environmental damage which has made climate change an irrefutable reality, are similarly correlated with pursuit of neoliberal ideals.

Neoliberalism is basically an economic philosophy which sees private enterprise and competition vital for harnessing human productivity. Neoliberal proponents believe that the market mechanism can delivers efficiency and effectiveness that could never be achieved through state interference and planning. Neoliberals thus try to minimise tax and regulation, and advocate privatisation of even the most basic and vital of public services including provision of water, education and health services.

Friedrich Hayek, one of the earliest proponents of neoliberalism back in the late 1930s, considered government efforts to create a welfare state, as being too close to the totalitarian ideologies of Nazism and Communism. Hayek found rich and powerful backers for his ideas, who in turn helped funded several think tanks, and even financed academics at the universities of Chicago and Virginia, to help propagate neoliberalism.

However, state-centric notion of development, such as use of public expenditure financed through taxation, still remained dominant in powerful

Western democracies. Such state led models of growth however did often fall prey to all sorts of ineffectiveness and even nepotism, particularly in the developing world, where international aid was also harnessed towards centralist economic growth, often championed by the local elites.

But by the 1970s, however, as Keynesian policies began to lose steam due to the economic crisis caused by the oil price shocks, Margaret Thatcher and Ronald Reagan, inspired by neoliberal thinkers, began giving massive tax cuts to the rich. They helped undermine trade unions, and allowed increasing deregulation, privatisation, and outsourcing. Through international agencies such as the IMF, the World Bank, and the World Trade Organisation, neoliberal policies were imposed on much of the developing world as well.

It is interesting to note how the passage of time has led the Labour Party in the UK, and the Democrats in the US, to also become proponents of neoliberalism. In developing countries like our own, the political manifestos of self-described leftist parties like the PPP has also shifted from progressive policies such as land reforms, for example, to instead focus on market based ideas such as increased liberalisation of agriculture as the means to alleviate rural poverty.

Yet, there is growing consensus that neoliberalism is a major problem. Public intellectuals like Noam Chomsky in his 2011 book 'Profit over people', and George Monbiot in his 2016 book 'How Did We Get into This Mess?' have made a damning critique of neoliberalism. Even a recent article, 'Neoliberalism: Oversold?', written by senior IMF staffers has grudgingly recognised that allowing capital to move freely across a country's borders can often lead to increased instability and inequality, instead of delivering greater economic growth.

It is no secret that big business and their lobbies have much more influence on government policies, than the poor and the middle class voters, even within countries which claim to be champions of the democratic world. This prevailing political disempowerment has enabled the rise of the far right and anti-establishment movements, capitalising on a misplaced fear of the other, but fuelled by a genuine disgruntlement against the status quo.

Scholars have rightly pointed out that Keynesian economics, with its emphasis on stimulating consumer demand to promote economic growth, can do little to tackle the urgent problem of environmental destruction, and other challenges of a highly integrated global political economy. What the world sorely needs is an alternative economic vision, one which strives for ecological and economic equilibrium rather than trying to pursue unlimited growth, the fruits of which, in reality, are unsustainable, and continue being enjoyed by a limited number of people.