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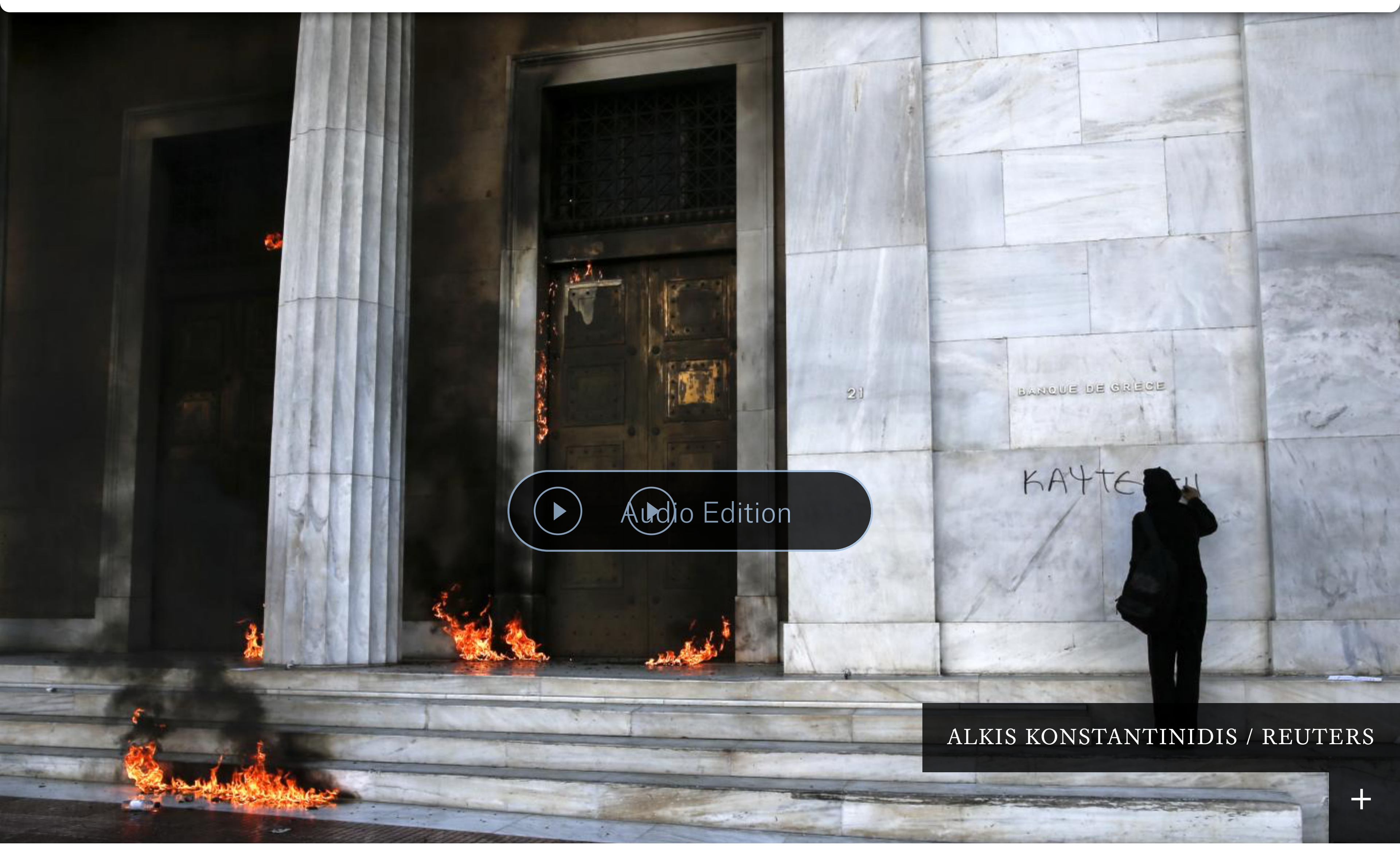

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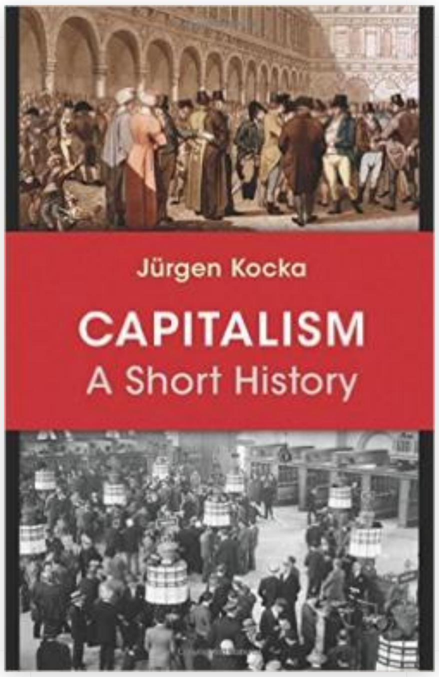
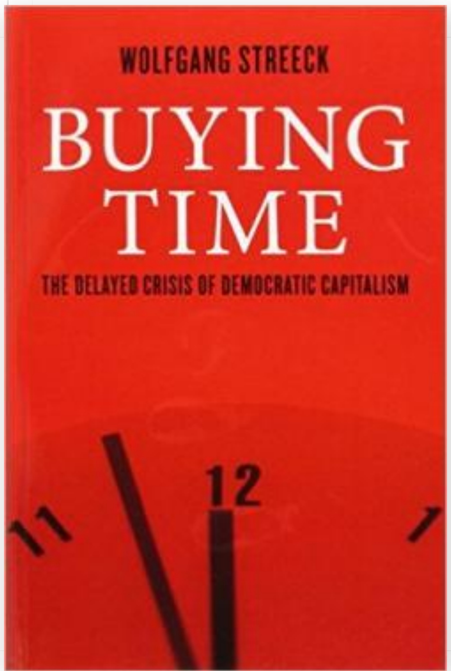
Capitalism in Crisis

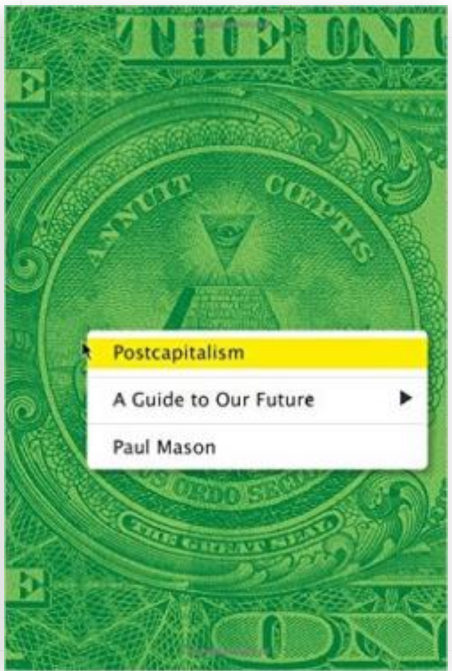
What Went Wrong and What Comes Next

By *Mark Blyth*

In This Review







Ever since the emergence of mass democracy after World War II, an inherent tension has existed between capitalism and democratic politics; capitalism allocates resources through markets, whereas democracy allocates power through votes. Economists, in particular, have been slow to accept that this tension exists. Instead, they have tended to view markets as a realm beyond the political sphere and to see politics as something that gets in the way of an otherwise self-adjusting system. Yet how democratic politics and capitalism fit together determines today's world. Politics is not a mistake that gets in the way of markets.

The conflict between capitalism and democracy, and the compromises the two systems have struck with each other over time, has shaped our contemporary political and economic world. In the three decades that followed World War II, democracy set the rules, taming markets with the establishment of protective labor laws, restrictive financial regulations, and expanded welfare systems. But in the 1970s, a globalized, deregulated capitalism, unconstrained by national borders, began to push back. Today, capital markets and capitalists set the rules that democratic governments must follow.

But the dominance of capital has now provoked a backlash. As inequality has widened and real wages for the majority of people have stagnated—all while governments have bailed out wealthy institutions at the first sign of trouble—populations have become less willing to accept the so-called costs of adjustment as their lot. A "double movement," in the words of the Hungarian historian Karl Polanyi, occurs in such moments as these, when those who feel most victimized by markets reclaim the powers of the state to protect them. The rise of Bernie Sanders and Donald Trump in the United States is a product of this reaction, as is the strengthening of populist parties in Europe.

Three recent books shed light on this continuing tension between the imperatives of the market and the desires of the people. Together, they offer a biography of capitalism: where it came from, what went wrong, and where it may be going in a world of stagnant living standards, widening inequality, and rising carbon emissions. And the picture they paint is a bleak one.

THE RISE OF CAPITALISM

Capitalism: A Short History, by the German historian Jürgen Kocka, is aptly named. In just 169 pages, it tells the story of capitalism from its origins in the ancient long-distance trade routes of Mesopotamia to the 2008 financial crisis. This is no mean feat. Yet such brevity requires some simplification, which comes at a cost.

> *The dominance of capital has now provoked a backlash.*

For Kocka, capitalism is "an essential concept for understanding modernity." More important, it is a set of institutions that enshrine property rights, promote the use of markets to allocate resources, and protect capital. And it is also an ethos, he claims, a set of principles and ideas. Defining capitalism so expansively allows Kocka to see its earliest forms developing among traders in Mesopotamia, in the eastern

Mediterranean, and along Asia's Silk Road, until, by the eleventh century, the beginnings of a merchant capitalist bourgeoisie had emerged on the Arabian Peninsula and in China.

Capitalism developed later in Europe, boosted by long-distance trade with Asia and the Arab world, between the twelfth and fifteenth centuries. Merchants formed cooperative institutions that led to greater risk sharing, which encouraged the accumulation of capital. This development, Kocka writes, led to "the formation of enterprises with legal personalities of their own," rudimentary capital markets, and, finally, banks whose fortunes became intimately connected with the rise of modern states through the management of their debts.

This alliance between merchant capitalism and the emergent state helped usher in the age of colonialism. Merchants, entrepreneurs, and conquistadors, with increasingly powerful states backing them, propelled European expansion. Critical to this expansion was the triangular trade, in which European merchants brought finished goods to Africa, traded them for slaves, and then exchanged those slaves in the New World for sugar and cotton that went back to Europe. This process helped embed capitalism deeper in Europe than in the Middle East and China: the scale of investment that such ventures required led to the rise of what would become known as "joint-stock companies" and the beginnings of what economic historians call "finance capitalism"—stock exchanges opened in Antwerp in 1531 and Amsterdam in 1611.

People wait in line to enter the NYCHires Job Fair in New York, February 2010.

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Much of the profits that early European capitalists enjoyed came from these profoundly illiberal activities. As Kocka points out, "capitalism . . . contains little in the way of resistance against inhumane practices." Yet in the long run, capitalism laid the groundwork for democracy, because the wealth it generated, and the possibilities that came with its new institutions, disrupted the guilds, helped cities expand, and allowed nineteenth-century industrialization to evolve into twentieth-century managerial capitalism.

BLAME THE BANKERS

In Kocka's narrative, each stage of capitalism begets the next, in an almost natural progression. Capitalism simply marches onward, for the most part benevolently—at least once the reformers abolished slavery and colonialism. But beginning around 1980, he writes, something started to go wrong. Firms started to derive a larger share of their profits from the financial sector than they did from real investments, a process economists call "financialization." This process, according to Kocka, "imparted a new quality to the system."

Modern finance, in contrast to the earlier, "productive" forms of finance that Kocka admires, seems to mainly consist of unproductive "locust" hedge funds that "cannibalize" good firms, contributing nothing to production in the wider economy. Meanwhile, Kocka insists, since the 1980s, governments have failed to exercise self-restraint, and publics have lived beyond their means. Massive growth in public and private debt in the developed world has been the result, which represents "a lasting source of destabilization for capitalism."

But this trenchant critique of modern finance sits oddly alongside the rest of the book. For Kocka, the system was doing just fine until the rot of modern finance set in. He insists that financialization represents a break in the evolution of capitalism. But he fails to explain where it came from, if it didn't emerge directly from those earlier forms of capitalism.

After all, the modern finance that Kocka condemns is not so different from the earlier, "productive" finance that he lauds. The financiers that got Germany into trouble in 2007 through their exposure to U.S. subprime mortgages were not "locust" hedge funds but traditional German development banks. And one of the world's largest derivatives traders at the time of the crisis was Deutsche Bank—hardly a new institution on the financial scene. In short, the idea that financialization may be not a perversion of capitalism but the next stage in its evolution seems to be a little too uncomfortable for Kocka to fully consider.

IN THE RED

The German sociologist Wolfgang Streeck also sees modern capitalism as flawed. Yet its current plight is not an aberration, he argues in *Buying Time*, but a direct consequence of the unraveling of the postwar marriage of capitalism and democracy.

Streeck's account focuses on Michal Kalecki, a Polish economist who came to prominence in the interwar period. Kalecki published a remarkable article in 1943 that predicted the economic turmoil of the 1970s. Kalecki argued that if full employment ever became the norm, workers would be able to move freely from job to job. Not only would this undermine traditional authority relationships within firms; it would also push wages up regardless of productivity levels, since workers would have more leverage to demand higher wages.

> *As governments began to rely more and more on debt, the tax-based states of the postwar era became the debt-based states of the contemporary neoliberal era.*

In response, firms would have to raise prices, creating a spiral of inflation that would eat into profits and lower real wages, which would, in turn, promote greater labor unrest. Kalecki argued that to restore profits, capitalists would rebel against the system that promoted full employment. In its place, they would seek to create a regime in which market discipline, with a focus on price stability rather than full employment, would be the primary goal of policy. Welfare protections would be rolled back, and the discipline that unemployment provides would be restored.

Kalecki's predictions proved astonishingly accurate. By the 1970s, as Kalecki had foreseen, inflation had risen dramatically, profits had fallen, and capital began its rebellion. Organizations as diverse as the Swedish Employers' Confederation and the Business Roundtable in the United States pressured governments to reduce taxes, especially on high earners. But cutting taxes in the recessionary early 1980s meant that revenues fell, deficits widened, and real interest rates rose as those deficits became harder to finance. At the same time, conservative governments, especially in the United Kingdom and the United States, set out to weaken labor and shrink the role of the state as they dismantled the regulations that had reined in the excesses of finance since the 1940s.

The financial industry could now grow unchecked, and as it expanded, investors sought safe assets that were highly liquid and provided good returns: the debt of developed countries. This allowed governments to plug their deficits and spend more, all without raising taxes. But the shift to financing the state through debt came at a cost. Since World War II, taxes on labor and capital had provided the foundation of postwar state spending. Now, as governments began to rely more and more on debt, the tax-based states of the postwar era became the debt-based states of the contemporary neoliberal era.

Greek riot policemen rest in front of graffiti written on the wall of a bank during violent demonstrations over austerity measur

This transformation has had profound political consequences. The increase in government debt has allowed transnational capitalists to override the preferences of domestic citizens everywhere: bond-market investors can now exercise an effective veto on policies they don't like by demanding higher interest rates when they replace old debt with new debt. In the most extreme cases, investors can use courts to override the ability of states to default on their debts, as happened recently in Argentina, or they can shut down an entire country's payment system if that country votes against the interests of creditors, as happened in Greece in 2015. The financial industry has become, Streeck writes, "the second constituency of the modern state," one more powerful than the people.

This shift from taxes to debt initially bought time for capitalism: it restored profits, destroyed labor's ability to demand wage increases, tamed inflation to the point of deflation (which increases the real value of debt), and even seemed to provide prosperity for all after the crisis of the 1970s. Mortgages and credit cards allowed private citizens to rack up deficits of their own—a process the sociologist Colin Crouch has described as "privatized Keynesianism." But it was all an illusion. Credit sustained the appearance of prosperity for the lower classes. In reality, the rich captured most of the newly created wealth. In the United States, for example, the top one percent more than doubled their share of the national income over the last three decades, as wages for the bottom 60 percent stood still.

In 2008, the financial crisis shattered this illusion. Governments bailed out the banks and transferred the costs of doing so to public budgets. Public debt exploded as governments bailed out the rich, and austerity measures, intended to reduce this new debt, have only compounded the losses of the majority of citizens. Capital continues to dominate democracy, especially in the EU: in Greece and Italy in 2011, technocrats replaced democratically elected governments, and in 2015, the so-called troika—the European Central Bank, the European Commission, and the International Monetary Fund—bulldozed Greek democracy.

So where Kocka blames profligate governments and debt-laden citizens for the current crisis, Streeck instead sees them as the victims. It's not lavish public spending, he shows, but rather falling tax revenues and financial bailouts that have created so much government debt and empowered capital. If states are spending extravagantly on voters, as Kocka and those who fetishize austerity maintain, there is precious little to show for it. "Had the rise in public debt been due to the rising power of mass democracy," Streeck writes, "it would be impossible to explain how prosperity . . . could have been so radically redistributed from the bottom to the top of society."

Streeck foresees a prolonged period of low growth and political turmoil ahead, in which states commanded by creditors, allied with transnational investors, struggle to get resisting debtor states into line: think of Germany and Greece. "The clock is ticking for democracy," Streeck writes, but "it must remain an open question . . . whether the clock is also ticking for capitalism."

"NEOLIBERALISM IS BROKEN"

For the British journalist Paul Mason, that question is closed: capitalism's current condition is terminal. In *Postcapitalism*, Mason writes that capitalism is "a complex, adaptive system which has reached the limits of its capacity to adapt." The roots of capitalism's demise, Mason argues, lie in the 1980s (also when Kocka saw problems arise), when capitalism was taken over by neoliberalism: an ideology and a set of policies that recognize no limits to the commodification of the world. Unfortunately for capitalism, "neoliberalism is broken." To explain why, Mason turns to the work of Nikolai Kondratieff, a brilliant Soviet economist whom Stalin had murdered in 1938.

According to Kondratieff, capitalism goes up and down in 50-year cycles. At the bottom of a cycle, old technologies and business models cease to function. In response, entrepreneurs, both public and private, roll out new technologies to open up untapped markets, and an upswing begins. This leads to a loosening of credit, which accelerates the upswing. These cycles bring to mind the concept of "creative destruction" popularized in the 1940s by the economist Joseph Schumpeter. But Mason downplays the importance of the entrepreneur, whom Schumpeter cast in a central role, and focuses instead on the effect of class-based politics on productivity.

Mason's first cycle runs from 1790 to 1848. The upswing began when British entrepreneurs first harnessed steam power to run their factories, and it ended with the depression of the 1820s. The subsequent downswing produced the revolutions of 1848, when the emergent bourgeois classes of Europe burst onto the historical stage. Mason's second cycle runs from 1848 to the mid-1890s. The spread of railways, the telegraph, and shipping drove growth until the depression of the 1870s. In the decades that followed, strong labor movements gained momentum all over the world, and capital, in response, became more concentrated. Electricity and mass production then powered a third upswing that crashed in the Great Depression and the massive capital destruction of World War II. After the war, a fourth cycle began with innovations in electronics and synthetics, improvements in the organization of production, and labor's relative victory over capital in the institutions of the welfare state. That cycle's upswing peaked in the mid-1970s, but this time, there was no major depression. The fourth cycle stalled.

THE END OF CAPITALISM

Mason's argument about why a major depression has not arrived during the past 40 years, the Great Recession notwithstanding, is partly conventional and partly surprising. The conventional explanation has four components. First, after U.S. President Richard Nixon took the dollar off the gold standard in 1971, the United States moved to a paper standard, which eliminated the constraints on deficit financing that the gold standard entailed. Second, the financialization of the developed economies masked the reality of stagnant incomes by substituting credit for wage increases. Third, the emergence of global imbalances in finance and trade allowed the United States to keep consuming as Asian countries stepped in as producers. Finally, advances in information technology empowered capital and weakened labor, and helped spread neoliberal practices across the globe.

That is a fairly familiar analysis. The unconventional part of Mason's answer harks back to Marx and Kalecki and stresses how neoliberalism managed to prevent profits from falling more effectively than any previous economic system. Mason borrows from Marx and Kalecki the idea that average profits in any market will fall due to both competition and the flood of capital into a new market, which reduce returns on investment. As a result, capitalists will always try to replace human labor with machines to protect their share of profits. During a downswing, as profits shrink, capitalists will do everything they can to boost their share of profits at the expense of labor: they will force employees to work intensively and will accelerate their attempts to replace workers with machines.

In the past, such attempts to restore profits simply by crushing labor failed. In each of the first three waves, one way or another, workers managed to resist. The best examples of such resistance were the postwar constraints on capitalism: strong unions, rigorous regulations, and generous welfare systems. When workers defy capitalists' attempts to squeeze profits from them by building such institutions, firms have to adapt. Rather than fight labor over the fixed distribution of income, they are forced to invest in improving workers' productivity, to the benefit of both parties: this was the post–World War II growth story.

A protester holds a sign reading "Give Us Our $$$$$ Back" as U.S. Treasury Secretary Timothy Geithner speaks in Washing

But under neoliberalism, capitalists have managed to squeeze labor in an entirely new way. Globalization obliterated the power of workers to resist, because if they did, capital—and jobs—could easily flow elsewhere. This explains why the number of labor strikes has declined so steeply all over the world. As Mason writes, "The fourth long cycle was prolonged, distorted and ultimately broken by factors that have not occurred before in the history of capitalism: the defeat . . . of organized labour, the rise of information technology and the discovery that once an unchallenged superpower exists, it can create money out of nothing for a long time."

Still, Mason believes that these factors have only delayed capitalism's inevitable collapse. Where Marx thought that organized labor would rise up and overthrow the system, Mason bets that information technology will destroy it from within. Digital goods, such as music files and software, create a real problem for markets: they destroy the role of price in balancing supply and demand. People can copy digital goods freely forever: they have zero marginal cost and are nonrival in consumption. When one person downloads a music file or a piece of code from the Internet, for example, she makes it no harder for anyone else to do the same. So the only way that firms can maintain their profits is by enforcing monopoly property rights: consider Apple and Samsung suing each other for the right to profit from patents or the need for major pharmaceutical companies to keep drugs prohibitively expensive.

Climate change may be the one bullet that capitalism cannot dodge.

Mason is optimistic about what will replace the profit motive. He points to decentralized networks such as Wikipedia, the "biggest information product in the world . . . made by 27,000 volunteers, for free," and the rise of the so-called sharing economy: nonmarket peer production systems, where work has value but cannot be priced in a traditional manner. The result is a "contradiction in modern capitalism . . . between the possibility of free, abundant socially produced goods, and a system of monopolies, banks and governments struggling to maintain control over power and information." In such a world, the central battle will be between those who want to preserve property rights and those who wish to destroy them in the name of democracy. The stakes, Mason argues, could not be higher. Without the revolution he calls for, the world will be vulnerable to a much greater threat: catastrophic climate change.

WHAT COMES NEXT?

Mason's chapter "The Rational Case for Panic" confronts what most economists and politicians tend to shy away from: the idea that capitalism in its current form is going to kill everyone. Of course, people have predicted an environmental apocalypse before. A group of experts called the Club of Rome famously published *The Limits to*

Growth in the 1970s, forecasting economic and environmental crises—and those predictions have failed to come to pass. But this time may be different.

The science behind climate change is better this time around, and it's conclusive. The world is in trouble. As Mason notes, in 2012, the International Energy Agency predicted that even if world leaders implemented all the announced emissions-reduction plans, carbon dioxide emissions would rise by another 20 percent by 2035. The world cannot burn 60 to 80 percent of remaining known carbon fuel stocks without causing catastrophic warming. But under capitalism, this is exactly what the world will do. Carbon taxes will do little to change this reality.

Add to this mix an aging developed world with huge pension liabilities and a climate-shocked developing world of young people who have nowhere to go, and it's little wonder that the Organization for Economic Cooperation and Development has forecast stagnant growth for the global economy for the next 50 years and an almost 40 percent rise in inequality in the world's rich countries. But despite this stark warning, Mason emphasizes an aspect of capitalism that both Kocka and Streeck underplay: its adaptive potential.

It is highly likely, for instance, that statistics such as GDP underestimate the impact of new information-based technologies. Hal Varian, Google's chief economist, might be exaggerating when he claims that the free search engine is worth $150 billion to users in the United States every year, but there is no doubt that Google has transformed the economics of finding information. Google saves everyone time and money—but that doesn't show up in GDP. Although capitalism may be reaching its adaptive limits, it has been more robust than most doomsayers realize.

Nonetheless, Mason thinks that climate change may be the one bullet that capitalism cannot dodge. Neoliberals often naively assert that capitalism will generate a miracle technology at just the right moment to stave off catastrophe. But Mason argues that previous Hail Mary passes, such as geoengineering and carbon capture, have failed to pay off. What gives him hope is that large-scale technological innovations may not be as important as micro-level changes in the structure of property rights themselves.

Whether or not such a restructuring will be enough to save the world remains unclear.

But Mason is right to hold out hope. Capitalism, in its current form, has reached a dead end. If ever there were a time for pessimism of the intellect and optimism of the will, it is now.

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