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Capitalism

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What is Capitalism

Capitalism is an economic system in which capital goods are owned by private individuals or businesses. The production of goods and services is based on supply and demand in the general market (market economy), rather than through central planning (planned economy or command economy). The purest form of capitalism is free market or laissez-faire capitalism, in which private individuals are completely unrestrained in determining where to invest, what to produce or sell and at which prices to exchange goods and services, operating without checks or controls. Most modern countries practice a mixed capitalist system of some sort that includes government regulation of business and industry.

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Capitalism

BREAKING DOWN Capitalism

Functionally speaking, capitalism is one process by which the problems of economic production and resource distribution might be resolved. Instead of planning economic decisions through centralized political methods, as with socialism or feudalism, economic planning under capitalism occurs via decentralized and voluntary decisions.

Capitalism and Private Property

Private property rights are very important in capitalism. Most modern concepts of private property stem from John Locke's theory of homesteading, in which human beings claim ownership through mixing their labor with unclaimed resources. Once owned, the only legitimate means of transferring property are through trade, gifts, inheritance or wages.

Private property promotes efficiency by giving the owner of resources an incentive to maximize its value. The more valuable a resource, the more trading power it provides the

When property is not privately owned, but shared by the public, a market failure can emerge, known as the tragedy of the commons. The fruit of any labor performed with a public asset does not belong to the laborer, but is diffused among many people. There is a disconnect between labor and value, creating a disincentive to increase value or production. People are incentivized to wait for someone else to do the hard work and then swoop in to reap the benefits without much personal expense.

For individuals or businesses to deploy their capital goods confidently, a system must exist that protects their legal right to own or transfer private property. To facilitate and enforce private property rights, capitalist societies tend to rely on contracts, fair dealing and tort law.

Capitalism, Profits and Losses

Profits are closely associated with the concept of private property. By definition, an individual only enters into a voluntary exchange of private property when he believes the exchange benefits him in some psychic or material way. In such trades, each party gains extra subjective value, or profit, from the transaction.

consumers over goods and services. All of this activity is built into the price system, which balances supply and demand to coordinate the distribution of resources.

A capitalist earns the highest profit by using capital goods most efficiently while producing the highest-value good or service. In this system, value is transmitted through those prices at which another individual voluntarily purchases the capitalist's good or service. Profits are an indication that less valuable inputs have been transformed into more valuable outputs. By contrast, the capitalist suffers losses when capital resources are not used efficiently and instead create less valuable outputs.

What's the Difference Between Free Enterprise and Capitalism?

Capitalism and free enterprise are often seen as synonymous. In truth, they are closely related yet distinct terms with overlapping features. It is possible to have a capitalist economy without complete free enterprise, and possible to have a free market without capitalism.

Any economy is capitalist as long as the factors of production are controlled by private individuals. However, a capitalist system can still be regulated by government laws and the profits of capitalist endeavors can still be taxed heavily.

"Free enterprise" can roughly be translated to mean economic exchanges free of coercive government influence. Although unlikely, it is possible to conceive of a system where voluntary individuals always trade in a way that is not capitalistic. Private property rights still exist in a free enterprise system, although private property may be voluntarily treated as communal without government mandate. Many Native American tribes existed with elements of these arrangements.

If accumulation, ownership and profiting from capital is the central principle of capitalism, then freedom from state coercion is the central principle of free enterprise.

How Capitalism Developed

Feudalism

Capitalism grew out of European feudalism. Up until the 12th century, less than 5% of the population of Europe lived in towns. Skilled workers lived in the city but received their keep from feudal lords rather than a real wage, and the farmers were essentially serfs for landed nobles. It took the Black Plague, one of the most devastating pandemics in human history, to

Nobles fought to hire enough serfs to keep their estates running and many trades suddenly needed to train outsiders, as entire guild families were wiped out. The advent of true wages offered by the trades encouraged more people to move into towns where they could get money rather than subsistence in exchange for labor. As a result of this change, birth rates exploded and families soon had extra sons and daughters who, without land to tend, needed to be put to work. Child labor was as much a part of the town's economic development as serfdom was part of the rural life.

Mercantilism

Mercantilism gradually replaced the feudal economic system in Western Europe, and became the main economic system of commerce during the 16th to 18th centuries. Mercantilism started as trade between towns, but it was not necessarily competitive trade. Originally, each town had vastly different products and services that were slowly homogenized by demand over time. After the homogenization of goods, trade was carried out in wider and wider circles: town to town, county to county, province to province, and, finally, nation to nation. When too many nations were offering similar goods for trade, the trade took on a competitive edge that was sharpened by strong feelings of nationalism in a continent that was constantly embroiled in wars.

Colonialism flourished alongside mercantilism, but the nations seeding the world with colonies were not trying to increase trade. Most colonies were set up with an economic system that smacked of feudalism, with their raw goods going back to the motherland and, in the case of the British colonies in North America, being forced to buy the finished product back with a pseudo-currency that prevented them from trading with other nations.

It was Adam Smith who noticed that mercantilism was not a force of development and change, but a regressive system that was creating trade imbalances between nations and keeping them from advancing. His ideas for a free market opened the world to capitalism.

Industrial Capitalism

Smith's ideas were well timed, as the Industrial Revolution was just starting to cause tremors that would soon shake the Western world. It was becoming apparent that colonialism wasn't the gold mine that the European powers thought it would be. Fortunately, a new gold mine was found in the mechanization of industry. As technology leaped ahead and factories no longer had to be built near waterways or windmills to function, industrialists began building in the cities where there were now thousands of people to supply ready labor.

the first time in history, common people could have hopes of becoming wealthy. The new money crowd built more factories that required more labor, while also producing more goods for people to purchase.

The term "capitalism" (originating from the Latin word "capitalis," which literally means "head of cattle") was first used in English by the novelist William Thackeray in his 1855 novel "The Newcomes," where it conveyed a sense of concern about personal possessions and money in general. Contrary to popular belief, Karl Marx did not coin the word, although he certainly contributed to the rise of its use.

Industrial Capitalism's Effects

Industrial capitalism was the first system to benefit all levels of society rather than just the aristocratic class. Wages increased, helped greatly by the formation of unions, and the standard of living also increased with the glut of affordable products being mass-produced. This led to the formation of a middle class that began to lift more and more people from the lower classes to swell its ranks.

The economic freedoms of capitalism matured alongside democratic political freedoms, liberal individualism and the theory of natural rights. This is not to say, however, that all capitalist systems are politically free or encourage individual liberty. Economist Milton Friedman, an advocate of capitalism and individual liberty, wrote in "Capitalism and Freedom" (1962) that "capitalism is a necessary condition for political freedom. Clearly it is not a sufficient condition."

In the 20th century, as stock exchanges became more public and investment vehicles opened up to more individuals, some economists identified a variation on the system: financial capitalism.

Capitalism and Economic Growth

By creating incentives for entrepreneurs to siphon away resources from unprofitable channels and into areas where consumers value them highly, capitalism has proven a highly effective vehicle for economic growth.

There is no historical evidence of any society experiencing compound economic growth prior to the rise of capitalism in the 18th and 19th centuries. Research suggests global per-

In subsequent centuries, capitalist production processes have greatly enhanced productive capacity. More and better goods became cheaply accessible to wide populations, raising standards of living in previously unthinkable ways. As a result, most political theorists and nearly all economists argue that capitalism is the most efficient and productive system of exchange.

The Differences Between Capitalism and Socialism

In terms of political economy, capitalism is often pitted against socialism. The fundamental difference between capitalism and socialism is the scope of government intervention in the economy. The capitalist economic model allows free market conditions to drive innovation and wealth creation; this liberalization of market forces allows for the freedom of choice, resulting in either success or failure. The socialist-based economy incorporates elements of centralized economic planning, utilized to ensure conformity and to encourage equality of opportunity and economic outcome. Other differences include:

- **Ownership:** In a capitalist economy, property and businesses are owned and controlled by individuals. In a socialist economy, the state owns and controls the major means of production. In some socialist economic models, worker cooperatives have primacy over production. Other socialist models allow individual ownership of enterprise and property, albeit with high taxes and stringent government controls.
- **Equity:** The capitalist economy is unconcerned about equitable arrangements. The argument is that inequality is the driving force that encourages innovation, which then pushes economic development. The primary concern of the socialist model is the redistribution of wealth and resources from the rich to the poor, out of fairness and to ensure equality in opportunity and equality of outcome. Equality is valued above high achievement and the collective good is viewed above the opportunity for individuals to advance.
- **Efficiency:** The capitalist argument is that the profit incentive drives corporations to develop innovative new products that are desired by the consumer and have demand in the marketplace. It is argued that the state ownership of the means of production leads to inefficiency, because without the motivation to earn more money, management, workers and developers are less likely to put forth the extra effort to push new ideas or products.

- **Employment:** In a capitalist economy, the state does not directly employ the workforce. This can lead to unemployment during economic recessions and depressions. In a be a stronger "safety net" in socialist systems for workers who are injured or permanently disabled. Those who can no longer work have fewer options available to help them in capitalist societies.

What Role Does the Government Play in Capitalism?

The proper role of government in a capitalist economic system has been hotly debated for centuries. Capitalism operates on two central tenets: private ownership and voluntary or free trade. These dual concepts are antagonistic with the nature of government. Governments are public, not private institutions. They do not engage voluntarily, but rather use taxes, regulations, police and military to pursue objectives that are free of the considerations of capitalism. Strictly speaking, any government intervention in a capitalist economy takes place outside the defined confines of capitalism.

In fact, some argue that a capitalist society needs no government at all. Anarcho-capitalism, a term coined by Austrian-school economist Murray Rothbard, describes a market-based society with no government. Politics and taxes would not exist in an anarcho-capitalist society, nor would services like public education, police protection and law enforcement that are normally provided by government agencies. Instead, the private sector would provide all necessary services. For example, people would contract with protection agencies, perhaps in a manner similar to how they contract with insurance agencies, to protect their life, liberty and property. Victimless crimes, such as drug use, and crimes against the state, such as treason, would not exist under anarcho-capitalism. Assistance to the needy would be provided through voluntary charity instead of compulsory income redistribution (welfare). The idea is that an anarcho-capitalist society would maximize individual freedom and economic prosperity; proponents argue that a society based on voluntary trade is more effective because individuals are willing participants and businesses have the profit incentive to satisfy customers and clients.

macroeconomic
Chicago School

What's the Difference Between a Mixed Economic System and Pure Capitalism?

When government does not own all of the means of production, but government interests may legally circumvent, replace, limit or otherwise regulate private economic interests, that is said to be a mixed economy or mixed economic system. A mixed economy respects property rights, but places limits on them: Property owners are restricted with regards to how they exchange with one another. These restrictions come in many forms, such as and eminent domain.

In contrast, pure capitalism, also known as laissez-faire capitalism, allows voluntary and competing private individuals to plan, produce and trade without coercive public interference. The free market reigns supreme.

The standard spectrum of economic systems places laissez-faire capitalism at one extreme and a complete planned economy (like communism) at the other. Everything in the middle could be said to be a mixed economy. The mixed economy has elements of both central planning and unplanned private business. By this definition, nearly every country in the world has a mixed economy, but contemporary mixed economies range in their levels of government intervention. The U.S. and the U.K. have a relatively pure type of capitalism with a minimum of federal regulation in financial and labor markets, sometimes known as Anglo-Saxon capitalism, while Canada and the Nordic countries have created a balance between socialism and capitalism. Many European nations practice welfare capitalism, a system that is concerned with the social welfare of the worker, and includes such policies as state pensions, universal healthcare, collective bargaining, and industrial safety codes.

When governments intervene in the economy, they often do so to promote the interests of the state. Restrictions on voluntary behavior or property rights are justified to pursue objectives that have been deemed valuable by members of the ruling body, including national defense, redistributed wealth or punishment for socially unacceptable behavior.

Since the Keynesian revolution in the first half of the 20th century, mixed economic policies have typically centered around state-measured economic aggregates. Examples include aggregate demand and supply, consumer price indexes (CPI) and gross domestic product (GDP). Governments and central banks try to restrict or otherwise manipulate the forces of capitalism through fiscal and monetary policy in pursuit of finding the correct macroeconomic results.

Crony Capitalism

Crony capitalism refers to capitalist society that's based on the close relationships between business people and the state. Instead of success being determined by a free market and the rule of law, the success of a business is dependent on the favoritism that is shown to it by the government in the form of tax breaks, government grants and other incentives.