Capitalism - A Summary

By Sam de Muijnck

"A man who thinks that economics is only a matter for professors forgets that this is the science that has sent men to the barricades."

Robert Heilbroner (1953, p. 14)

Introduction

Political-economic systems define the ways in which the production and distribution of goods and services are organised that shape people's lives. We live in capitalism, but what does that mean? This text gives readers an idea by summarising the book Capitalism by Geoffrey Ingham (in particular its first three chapters). Learning the basics of how our economies are organised helps economists do their work better as they can place current issues and policy debates in context. This will also help them think systematically about how economies as a whole might function, what dynamics they might have and how the different parts operate and interact with one another.

Capitalism describes a political-economic system in which market mechanisms are dominant, as not only goods and services, but also land, labour, and capital are bought and sold on markets. The political-economic system derives its name from the fact that capital goods, also called 'the means of production', are largely privately owned, by a class of individuals known as the capitalists. Capitalists aim for profit and accumulate capital by hiring workers and selling the produced products to consumers. In this way, the economy and production are organised around the pursuit of profit, rather than around political obligations, reciprocity, social norms, or for own consumption as with subsistence farming. As such, capitalism is something more specific than simply an economy with markets, money, or profit-seeking, as these have existed all throughout history.

Capitalism is one of the most hotly debated topics in economics and politics. Therefore, it helps readers understand the topic better by focusing on core insights by five radically different key thinkers on capitalism. In this way, a range of views are represented, from wanting to overthrow, to reform, to defend the system. Furthermore, we try to stay away from strawmen that idealise or demonise capitalism, and instead try to convey a more complex and nuanced understanding of the political-economic system with both strengths and weaknesses, allowing readers to make up their own mind.

While there are many different opinions about capitalism, many key thinkers agree on what the core dynamics of the capitalist system are. The central profit motive, endless accumulation of capital and drive for economic growth, private ownership of the means of production, wage labour, ever higher levels of specialisation, relentless competition for market dominance, continuous expansion into new sectors and new markets, increasing commodification of natural and social life, recurrent financial and economic crises, and rapid mass-marketing of innovations, are all generally recognised properties of capitalism.

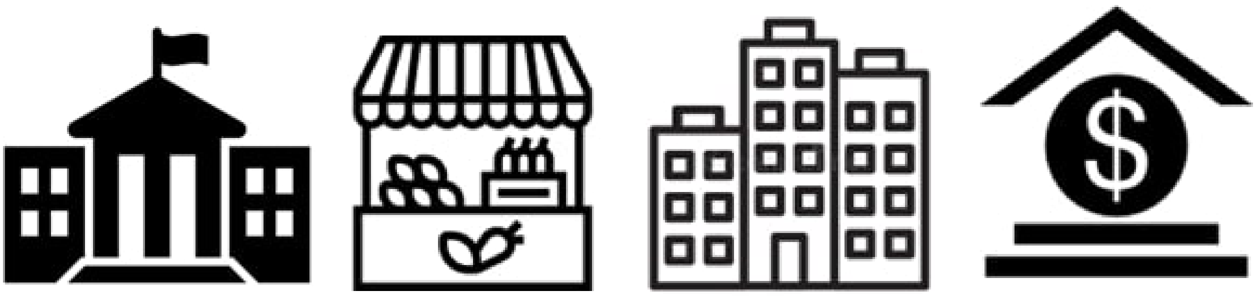
Which of these is most important and distinguishes capitalism from other political-economic systems is, however, widely debated. A common definition of capitalism is an economy in which the majority of the means of production are privately owned. This is generally contrasted with social ownership, either by the state or cooperatives, which is argued to define socialism. In addition to this dichotomy between private and social ownership, a dichotomy between allocating resources via markets or planning is common. Combined, these two dichotomies allow economies to be classified as either market capitalism, command capitalism, market socialism or command socialism. Others, however, argue these dichotomies do not help us understand actual political-economic systems, whether its social democratic Scandinavia, Soviet Russia, or worker-managed Yugoslavia, and for example emphasise the power relations between social classes, the state, and civil society.

Here no position is taken as to what characteristic defines, or captures the essence of, capitalism. Instead, first, four widely recognized basic institutions of capitalism are described to get a better idea of how the political-economic system works. Second, a brief overview of different normative views of capitalism is given. Third, the ideas of five key thinkers on capitalism are discussed to become familiar with different ways of understanding the political-economic system.

Basic institutions of capitalism

Four basic institutions of capitalism:

- State: Enforcement of private property rights and legal contracts
- Markets: Market exchange of products and the factors of production
- Firms: Production by workers for enterprises owned by profit-seeking capitalists
- Money: Money creation by commercial banks through credit



First, enforcement of private property rights and legal contracts by the state. While the concept of owning your own things might be as old as humanity, private property as we know it today is far more recent. In contrast to what is often called personal property, private property does not only refer to items people use frequently in their daily lives, but can practically refer to everything, ranging from a piece of land on the other side of the world to an idea about how to produce something more efficiently. In both cases you have exclusive ownership and it is illegal for others to use it.

These private property rights do not exist without being actively protected (ultimately through violence). This is one of the crucial roles of the state in capitalism. But ownership is not an absolute, or simple binary, matter and is thus often conceptualised as giving a bundle of rights over the asset. In other words, ownership gives you certain rights, but not others. You might own a house, but not be allowed to run a factory there. Additionally, most, if not all, contracts are incomplete, meaning it does not fully specify every possible scenario. This makes the legal and social systems surrounding contracts of critical importance for how transactions happen. The specific rules around property and contracts can differ substantially and, as such, it is significant that English and New York common law have been dominant in the history of capitalism.

One of the rights often associated with private property is the right to sell an asset. This brings us to the second core institution: markets. Markets for goods and services have existed throughout much of history. It is, however, relatively unique to have the large-scale buying and selling of land, labour and capital through markets. This gives markets in capitalism a central role in society as much of people's lives becomes based on the principle of exchange. The three factors of production have unique characteristics compared to goods and services. Karl Polanyi (1944), for example, deemed these 'fictitious' commodities because, in contrast to goods and services, land, labour and money are not, and cannot be, produced for the market.

The third core institution of capitalism has given it its name: the fact that the dominant economic organisations are capitalist firms. A firm is capitalist when the owners of the capital, the capitalists or shareholders, have the power to make the decisions and direct the organisation. The typical capitalist firm is run through wage labourers, supervised in a hierarchical structure by managers. The products that are produced by the firm are the sole property of the capitalists, as the workers and managers only have the right to their wages. These commodities are sold on markets in order to make a monetary profit for the capitalists, thus putting the profit motive at the core of these economic organisations.

Fourth, while capitalism did not invent money, in a way the system puts it at the centre of societal life. Credit-based bank systems in particular are a distinctive feature of capitalism. In these systems, debt is transferable in the sense that money, nothing more than an IOU (referring to "I Owe U [You]"), can be used as means of payment to third parties. This money takes various forms, but the lion's share is actively created by banks by issuing credit with property functioning as collateral, thereby injecting the economy with new purchasing power. According to Schumpeter, it is precisely this characteristic of capitalism that makes it so dynamic.

Finally, it should be noted that there are many varieties of capitalism and that its relation to other societal systems is hotly debated. For instance, think of the differences between the early modern Dutch economy and the current day Indian economy. Both, however, are often described as capitalist political economies. The literature on the varieties of capitalism was initially centred around the concepts of liberal and coordinated market economies, to respectively describe Anglo-Saxon and north-western European countries based on their differences in industrial relations, vocational training and education, relations with employees, corporate governance and inter-firm relations. Recently, researchers have tried to expand the number of concepts to also capture Asian and Latin American varieties of capitalism, with concepts such as hierarchical market economies. This also illustrates that the concept of capitalism is a simplification of the real world, as actual economies consist out of many different ways of organising, with for example economic interactions happening through markets but also through community and kin relations, capitalist firms but also worked-owned and run cooperatives, and formal wage labour but also informal paid work as well as unpaid forms of labour.

This also brings us to ideas about the relation of capitalism to other societal systems. Traditionally, many, including both liberals and socialists, view capitalism as replacing the worse economic system of feudalism and thereby as progress. Others, and significantly key thinkers from marginalised groups, see, however, the rise of colonialism and slavery as deeply intertwined with the history of capitalism, and thus not representing deviations from the economic system but as essential elements of it. Similarly, there is a lot of debate about the relationships between capitalism and patriarchy; and capitalism and democracy. The focus in this text is however on understanding the basics of capitalism, and thus does not go into detail into the varieties of capitalism and its relation to other societal systems.

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Normative Views on Capitalism

Beyond an analytical understanding of the main structures and dynamics of capitalism, the main normative arguments surrounding it are also important. Here, we set out a brief overview of these debates.

Hirschman (1982), and updated in 2007 by Fourcade and Healy, identified the following three fundamentally different moral positions, respectively arguing capitalism is (1) civilising; (2) destructive; or (3) feeble.

The civilising view is very important in the liberal tradition. It claims that capitalism not only leads to economic growth, freedom, and fair and efficient outcomes, it also causes people to behave more rationally, cooperatively, freely, creatively and morally. Thus, capitalism is more than a way of organising economic systems: it changes the social morality of a society away from armed violent power struggles and towards more productive and harmonious forms of competition. Economic integration through expanding markets creates social integration by binding people together in webs of mutually beneficial exchange. And thanks to the price mechanism these trades ensure that production and resources are dedicated to those products with most demand thereby leading to otherwise unachievable levels of efficiency.

Those that are more critical of capitalism, on the other hand, argue that capitalism is destructive: it causes people to behave hedonistically, selfishly, short-sightedly and wastefully. Instead of creating a harmonious world as the civilising view argues, the destructive view argues capitalism creates alienation, exclusion, coercion, subordination, deception, inequality and exploitation. People are unable to live freely or cooperate harmoniously with each other, as they are forced by the threat of poverty and starvation to follow dictates of the capitalist system and engage in market competition and conflict. And while capitalist economies produce unprecedented amounts of stuff, they are in fact incredibly inefficient. Production and resources are dedicated to those with most money and thus most effective demand, but often with the least real needs. This results in enormous unnecessary production amidst vast amounts of unmet needs.

Note, however, that despite all their differences both the civilising and destructive view assume that capitalism is a very powerful political-economic system which fundamentally shapes the societies it manifests itself in.

The feeble view argues, instead, that capitalism is not inherently good or bad. Rather, its effects depend on the kind of social and cultural institutions within which it is embedded. Some, for example, argue that capitalism only creates positive outcomes in certain cultures, in this case amongst Protestants, while it creates negative outcomes in other cultures, for instance Catholics. Others argue it is about choosing the right policy mix, such as fair and enforced property rights or countercyclical fiscal policy, and thus think it is quite possible to move from a negative version of capitalism to a positive version. Finally, there is also a more differentiated view, which argues that there are multiple successful varieties of capitalism. While the Anglo-Saxon liberal and continental European coordinated market economies, for example, function differently in terms of flexibility of labour markets and short- vs long-term focus of corporate governance, they can both lead to economic success. In each case, whether they emphasise cultural legacies, having good political institutions, or having a prospering variety of capitalism, the point is that capitalism in itself is not desirable or undesirable, but that it depends on which specific forms of economic organisation are dominant, and what institutions these are embedded in.

Key thinkers on capitalism

We explain the different insights into how capitalism works by discussing the ideas of the 5 key thinkers discussed in Capitalism in chronological order, firstly very briefly and then in slightly more detail.

Adam Smith, writing in the late 18th century, argued against mercantilist policies aiming to amass and hoard wealth through military power and claiming natural resources. Instead he argued the next change of economic development was characterised by wealth creation through commerce. Unlike with feudal obligation or the compulsion of slavery, individuals were free to pursue their own interests in the market, which would ensure production is dedicated to the goods and services people want most. By expanding markets it becomes possible to increase specialisation and the division of labour, leading to higher levels of productivity and wealth. There is considerable debate over how to interpret Smith and how they are relevant for today's world, with some viewing him as a proto free market capitalist and many others argue this is incorrect and misleading as Smith argued for commerce and markets, not capitalism, and against mercantilism but not other forms of government action. There are similar debates over how to interpret the other thinkers, especially in the light of current economic questions.

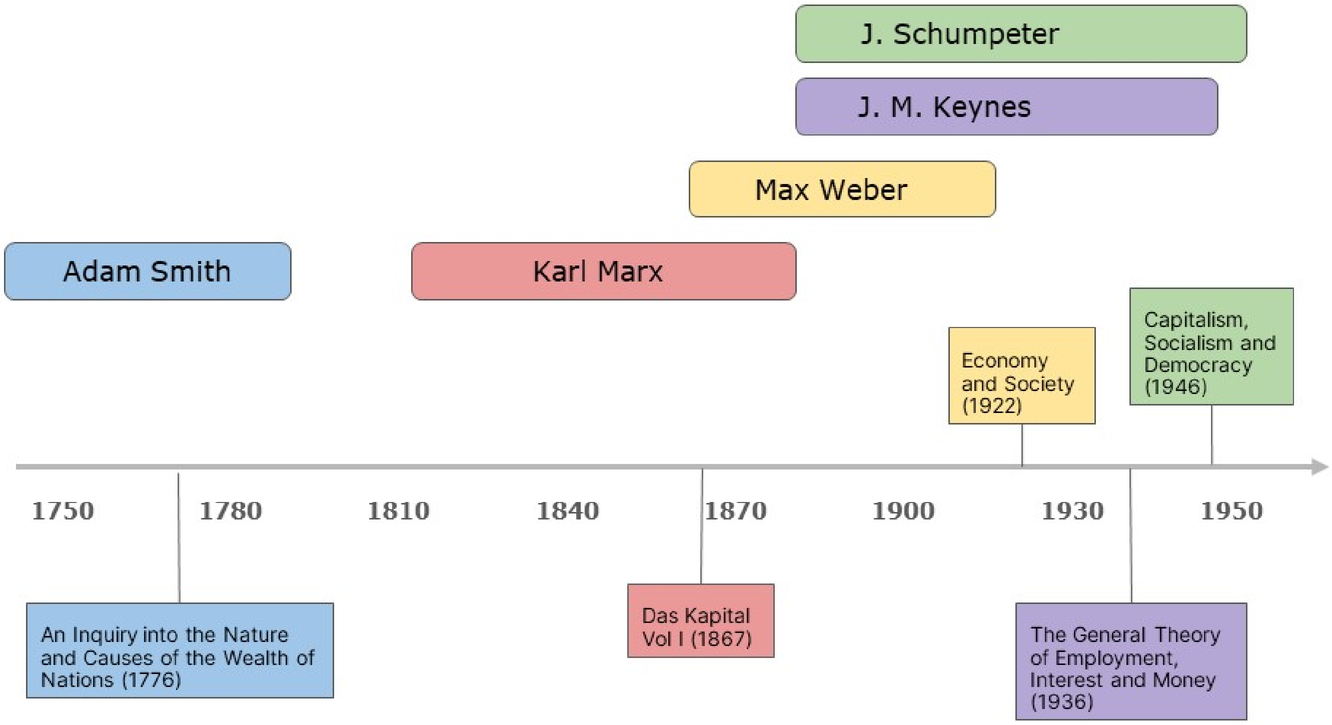
Karl Marx, writing as the 19th century progressed and industrial capitalism became dominant around the world, was deeply influenced by Smith but emphasised the importance of the unequal property relations and contradictions in the capitalist system that cause economic crises. This led Marx to the conclusion that the system does not function to satisfy human needs, but that instead the realisation of monetary profit through capturing surplus value has become a goal in itself and is often in opposition to people's wellbeing. The most profitable commodities are produced and violence of the state is used to create and maintain exploitation and inequalities in ownership. While workers are legally free and equal, they are forced to sell their labour and work as subordinates of capitalists to make a living as they own no means of production which would allow them to independently create value.

Max Weber, writing around the turn of the 19th and 20th century, tried to understand how it became possible to organise human life around continuously calculating in bureaucratic organisations how to maximise profits. Rather than just allowing people to follow their inner nature, he understood capitalism as a highly unique social system that evolved out of Western economic, political and cultural historical developments.

The emergence of an international network of bureaucratic states with monopolies over violence within their territory and individual citizenship and private property rights, allowed power struggles to go through and take place in markets. Protestantism, in particular, was instrumental in creating capitalist values of capital accumulation focused on earning as much as possible rather than enough. Economic life increasingly became commercialised as considerations grounded in emotional ties, family obligations and traditional social norms that might interfere with strict economic rationality in the calculation and pursuit of profit were dispensed with. And while capitalism arose out of religious devotion, it has become an inescapable "iron cage" in which rational calculation, bureaucracy and efficiency control human life.

Joseph Schumpeter, writing during the upheavals of the First and Second World War, the great depression, and the rise of communism and fascism, emphasised the dynamism of capitalism. Rather than portraying capitalism as a static efficient system in which markets are in optimal equilibrium, he argued its strength was turbulent progress and creative destruction caused by credit-financed entrepreneurship. Capitalist entrepreneurs don't simply compete, they change the nature of the competition. Rather than passively responding to price signals, companies constantly revolutionise the system with new goods, supply of raw materials, production methods, markets, and organisational structures to realise profit. Further dynamism comes from the fact that commercial banks create money through loans to business, thereby financing new economic activities.

John Maynard Keynes, like Schumpeter writing during the early 20th century, argued depressions and unemployment can be prevented without sacrificing economic and political liberalism with counter-cyclical fiscal and monetary policies. He challenged the economic orthodoxy of his time that saw wage cuts as the solution for unemployment and that argued government budgets should always be balanced. Government deficits were assumed to necessarily lead to inflation as it was thought that markets automatically generate full employment. Keynes argued these ideas were wrong since full employment was actually a rare phenomenon due to persistent deficiencies in effective demand, which were made worse by wage cuts. Governments have an important role in stabilising and directing markets as individually rational actions can lead to collective irrationalities and disasters. Furthermore, as the world is full of uncertainty people have a preference for liquidity and often follow their animal spirits.



Before we go into more detail into the ideas of these five white male thinkers, it should be noted that there are of course many other crucial thinkers on capitalism from Thorstein Veblen, Joan Robinson, Friedrich Hayek, Raúl Prebisch, John Kenneth Galbraith, Milton Friedman, Cedric Robinson, and Marilyn Waring through the 20th century, to Ha-Joon Chang, Raghuram Rajan, Deirdre McCloskey, Jayati Ghosh, Geoffrey Hodgson, Thomas Piketty, Anwar Shaikh, Mariana Mazzucato, Shoshana Zuboff, and Katharina Pistor more recently.

A few suggestions for further reading and watching are:

- Conceptualizing Capitalism: Institutions, Evolution, Future by Geoffrey M. Hodgson, from 2015.
- 23 Things They Don't Tell You about Capitalism by Ha-Joon Chang, from 2010.
- Does Capitalism Have a Future? by Georgi Derluguian, Craig Calhoun, Michael Mann, Randall Collins, & Immanuel Wallerstein, from 2013.
- The Code of Capital: How the Law Creates Wealth and Inequality by Katharina Pistor, from 2019.
- The Age of Surveillance Capitalism by Shoshana Zuboff, from 2018.
- Capitalism, Alone by Branko Milanović, from 2019.
- Documentary series like Capitalism: A six-part series by Ilan Ziv, but also the old classics Age of Uncertainty by Galbraith and Free to Choose by Friedman.
- Learning about capitalism through art from the classic novels of Charles Dickens, Leo Tolstoy, George Orwell and Hannah Arendt to the more recent visual street art Shop Until You Drop by Banksy, the movie Margin Call or the rap battles between Hayek and Keynes or Mises and Marx.

Adam Smith (1723-1790): The pursuit of individual self-interest in the market produces public benefits

"the propensity to truck, barter, and exchange one thing for another... is common to all men, and to be found in no other race of animals ... Nobody ever saw a dog make a fair and deliberate exchange of one bone for another with another dog."

Adam Smith (1776, 25-26)

Moral philosopher and pioneer political economist

Main publications

- 1759: The Theory of Moral Sentiments
- 1776: An Inquiry into the Nature and Causes of the Wealth of Nations

Personal life

Born close to Edinburgh, two months after his father's death, who was a lawyer. Smith was very close with his mother and, as he never married, he lived with her much throughout his life. At three years old, he was abducted by Romani but released quickly after without harm. Went to university at 14 years, made few friends and was said to be socially awkward. Three years later he went to Oxford, which he found lacking intellectually and where he was punished for reading a book by David Hume. He was so unhappy, probably suffering mental distress, that he left before his scholarship ended.

Professional life

He became a central Scottish Enlightenment moral philosopher and source of inspiration for classical liberalism and political economy as he forcefully argued against 18th century mercantilist policies.

Influences

He was close to Hume and travelled through Europe to meet fellow intellectuals, such as Voltaire, Benjamin Franklin & the physiocrat economist Quesnay.

Theory of sympathy

Before writing about political economy and helping establish it as a scholarly field, Smith wrote, like other intellectuals and philosophers of his time, on many diverse topics from (meta)physics and astronomy to jurisprudence and psychology. The publication of The Theory of Moral Sentiments initially made Smith a well-known and respected thinker. In it he argues that moral sentiments, such as sympathy and empathy, are innate and that they guide people to form moral judgments. He also reasons that individuals are motivated to act in ways that will be approved of by others, leading people to seek approval of the "impartial spectator".

There is debate over how Smith's earlier works and thinking on sympathy and moral sentiments relate to his later work on political economy and self-interest. While some argue they are in conflict with each other, others argue they are consistent but only focus on different aspects of human life. Even more, it has been argued the ideas are closely related saying that Smith thought self-interest is held in check by sympathy with regards to morality and by market competition with regards to economic matters.

Commerce as the cause of wealth

Puzzle: How did small Holland with few natural resources win over big Spain with a global empire and endless natural resources (including gold and silver)?

Not because of military power and natural resources, which were the objects of then dominant mercantilist policies aiming to gain power by amassing and hoarding wealth within a territorial state.

But because of commerce, which Smith argued was a new stage of economic development where the creation of wealth was the result of individuals pursuing their own interests, not the strategies of monarchs.

'Commercial society': No longer largely closed self-sufficient household and manor economies based on traditional norms, reciprocity and redistribution, but instead, more division of labour (specialisation) based on an expanded market. The market through the mechanism of demand and supply ensures that production is dedicated to the goods and services that people want most and are willing and able to freely pay for.

Smith thought that the increase in wealth from commerce was not unlimited and that countries would eventually reach a stationary state as investment opportunities would decline. Keynes later also expected capital accumulation to reach saturation as material abundance would be achieved and interest and profit rates would decline. He wrote that the grandchildren of his generation would around 2030 have solved "the economic problem, the struggle for subsistence" and move away from the obsession with money-making and would focus on the true "art of life" (1930, pp. 4-5). More recently researchers have looked at ideas about stationary economies from an ecological perspective.

The market as a harmonising 'invisible hand'

Unlike feudal obligation or the compulsion of slavery, the market organises economic activities in a 'commercial society'. Free individuals interact by buying from and selling to each other. Prices signal crucial information about the scarcity of goods, services, land, labour and capital. The spontaneous result is a complex division of labour and market equilibrium as self-interest ensures that market imbalances are corrected.

Prices: In the short term, natural and market prices often diverge, but, in the long run, the competitive market ensures they converge.

- Market price: Determined by scarcity and the balance of supply and demand at a point in time.
- Natural price: Equal to the costs of production.

The market is not only efficient but also just and harmonious:

- Just: Market actors receive the return equivalent to their contribution to aggregate wealth.
- Harmonious: Exchange is based on mutually advantageous deals and interdependence. This helps resolve the eternal ethical question of the relationship between individual conduct and the general collective welfare. If self-interest led to the wealth of nations, then, as Mandeville had expressed in his Fable of the Bees (1714), 'private vices' were the source not only of 'public benefits' but also of 'public virtue'.

It should be noted that Smith himself rarely used the metaphor of the 'invisible hand', in contrast to how he is often portrayed and remembered. In fact it is only mentioned once in the Wealth of Nations to explain why capitalist investors have a home country bias.

The use of state power for self-enrichment

In his polemic against the absolutist monarchies and mercantilist policies of the 18th century, Smith relegated politics and the state to a minimal role in economic affairs. The idea that economic coordination and wealth creation were the spontaneous, unintended consequences of self-regarding individuals in the marketplace meant that state involvement in economic activity would often be counterproductive. Smith was not against a role for the government in the economy, but we was opposed to self-interested actions by powerful interest groups and social elites that hurt the common good, what today is often referred to as 'crony capitalism', saying:

> *"People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices".*

He also not only celebrated the division of labour, but also worried about what is often called 'alienation' saying that because of it the worker "becomes as stupid and ignorant as it is possible for a human creature" and that there is "corruption and degeneracy of the great body of the people .. unless the government takes some pains to prevent it" (Smith, 1776, pp. 178-179). In particular Smith saw three indispensable roles for the state in the commercial stage of society:

- The state should provide for the defence of the territory in which perfect liberty could be exercised.
- Uphold the rule of law as without secure property rights over the use and disposal of goods and capital the market cannot function.
- The state should provide public goods which may never be profitable for individuals to produce 'privately', such as infrastructure (roads, bridges, harbours and canals).

Karl Marx (1818-1883):
A system based on the exploitation of workers

"The history of all hitherto existing society is the history of class struggles. Freeman and slave, patrician and plebeian, lord and serf, guildmaster and journeyman, in a word, oppressor and oppressed, stood in constant opposition to one another"

Karl Marx (1848, p 2)

Philosopher, journalist, political economist and socialist revolutionary

Main publications (both with Friedrich Engels)

- 1848: The Communist Manifesto (breakthrough with large public)
- 1867-94: Das Kapital (magnus opus; last two volumes were finished and published after his death by Engels)

Personal life

Born in Germany to Protestant parents with Jewish roots. His father was a liberal lawyer, and his mother came from a well-off merchant family. He studied law and philosophy, but drunk and duelled a lot. He even got in jail as he antagonised aristocratic campus organisations. This resulted in beef with his parents and him not attending the funeral of his father. Going against social norms, his aristocratic childhood friend cancelled her engagement with an aristocrat to marry young and middle-class Marx.

Professional life

Throughout his life he worked in academia, journalism and politics. He became stateless in 1845 for his journalist work and lived in exile with his wife and children in Paris, Brussels but mostly in London. They lived in poverty and often relied on Engels' money. His wife once sold Marx' pants to buy food and Marx's mother once said: "if only Karl made capital instead of just writing about it".

Influences

- German philosophy: Hegel and philosophical materialism
- French socialism: Rousseau, Saint-Simon, Proudhon, Fourier
- British political economy: Smith, Ricardo, Sismondi

Capitalism as social system

Marx agreed with Smith that specialisation, competition and trade caused unprecedented wealth, but argued he failed to notice the importance of the unequal property relations and contradictions in the capitalist system that cause economic crises.

Capitalism is oriented around the realisation of monetary profit by the production of commodities with an 'exchange-value'. In contrast to Smith, Marx did not think this would almost fully overlap with the creation of 'use-values' for the satisfaction of human needs.

Classical political economists often presented the capitalist system as an objective, or natural, state of affairs which is determined by material forces. But Marx argued we should distinguish between material forces and social relations, as societies (can) use technologies and material resources in different ways based on how their economies are organised:

- Material forces: The means of production (machine technology, sources of energy, raw materials, land, skills and knowledge)
- Social relations: Different historical patterns of ownership, control and organisation of the material forces (slavery, feudalism, capitalism)

Stages of economic development

Smith (1762):

- The Age of Hunters
- The Age of Shepherds
- The Age of Agriculture
- The Age of Commerce

Marx (1848):

- Primitive communism: Gift economies of hunter-gatherers based on reciprocity.
- Ancient mode of production: Agricultural slave societies where enslaved people produce surplus for free citizens.
- Feudal mode of production: Agricultural societies where serfs produce surplus for nobles (alongside small groups of bourgeois artisans and merchants engage in simple commodity production, meaning independent producers selling their own products).
- Capitalist mode of production: Industrial societies where workers produce surplus for capitalists through production for exchange for the pursuit of profit and accumulation of private property.
- Socialist mode of production: Industrial societies where production is democratically controlled and devoted to the satisfaction of human needs.

Turning money into more money

Money as a means to an end or goal in itself:

- As a means to an end: Trade throughout history before capitalism was characterised by realising real production and consumption, also known as Commodity-Money-Commodity (C-M-C'). This means that objects are produced and sold in order to obtain the money that will enable the producer to gain the satisfaction of other utilities.
- As a goal in itself: Capitalism is characterised by capital accumulation by which money and capital are turned into more money and capital, also known as Money-Commodity-Money (M-C-M'). This means that money is invested in the production of commodities meant for exchange with monetary profit as the primary goal. Furthermore, (speculative) finance is often simply Money-Money (M-M'), meaning that monetary profit is realised without any real economic activity or production.

Selling yourself

Working for yourself to create value or as a subordinate to earn money:

- Working for yourself to create value: Property-owning peasants can work to create products to use or consume themselves or trade with others.
- Working as a subordinate to earn money: Property-less wage-labourers, the ‘proletariat’, have to sell their labour power as this is their only way to make a living.

In this way their labour becomes a tradable good, which exchange-value is, just like other commodities, determined by the amount of labour time needed for its reproduction, meaning the food, clothing and so on needed to maintain a worker’s family. The wage contract does not merely specify the terms of the contractual exchange of effort for reward, it also entails the workers’ subordination to the authority of the owners and controllers of capital.

Building on Hegel’s ideas of dialectics and self-development, Marx argued that human beings possess both their actual and potential selves. In contrast to Hegel who emphasised ideas and spiritual aspects, Marx thought this process of self-actualization happens through labour and material aspects. An economy which forces people to sell their capacity to transform the world, their labour, causes people to be estranged from their human nature.

Inequality as the result exploitation and control over the means of production

Smith: People receive relative to their functional contribution and productivity:

- Rent: Landlords with fertile land will receive higher rents
- Wages: Workers with scarce skills will receive higher wages
- Profit: Capitalists with more productive machinery will make more profits

Marx: Inequalities between social classes are based on ownership and power relations:

- Rent: Rent does not simply express the productivity of the land, it also reflects the unequal property relation between landlord and tenant. It is about who gets to appropriate and claim assets as their legal property with the backing of state violence if necessary. Example: With the Enclosure Acts, English rulers took away the rights of farmers to common and waste lands, forcing them to move to towns and cities and sell their labour as ‘proletariat’. Marx thus draws attention to inequalities that already exist before certain production takes place, also referred to as ‘primitive accumulation’ and predistribution.
- Wages: Workers receive minimal subsistence wages that keep them and their families alive (an idea developed by David Ricardo). While legally free and equal, workers are forced to sell their labour to make a living as they own no means of production which would allow them to independently create value.
- Profit: Capitalists own the means of production and therefore can appropriate the surplus value, as profit, that is created by workers on top of the value of their wages (building on the ideas of Smith and Ricardo on the labour theory of value).

Contradictions and crises

Recurrent crises of overproduction result from the production of commodities for their monetary exchange value rather than their utility.

The market not only failed to transmit the pursuit of individual interest into maximum collective welfare, it also resulted in the anarchy of uncoordinated economic decision-making that brought about unintended and uncontrolled fluctuations between over- and under-production.

Competition between capitalists:

- Marx agreed with Smith: it accounted for dynamic economic progress with the bourgeoisie constantly developing and revolutionising the forces of production.
- But Marx added: It also resulted in an anarchical drive to produce commodities with exchange-value which led to periods of overproduction followed by recessions as capitalists tried to cut their losses by reducing output.

According to Marx, capitalists were their own 'gravediggers' as the bourgeoisie were powerless to prevent the normal functioning of capitalism from undermining the very thing that it was organised to achieve as there is a falling rate of profit. Profits only come from the appropriated surplus value of labour. As capitalism develops it becomes more capital intensive and more productive through technological progress and thus the source of profit, labour, becomes relatively smaller. Through cyclical crises this process will deepen, until there is a breaking point which will result in a workers' revolution that will overhaul the social relations while building on the material forces.

Max Weber (1864-1920): Continuous 'rational' calculation by bureaucratic enterprises to maximise profit

"The capitalistic economy of the present day is an immense cosmos into which the individual is born, and which presents itself to him, at least as an individual, as an unalterable order of things in which he must live. It forces the individual, in so far as he is involved in the system of market relationships, to conform to capitalistic rules of action. The manufacturer who in the long run acts counter to these norms, will just as inevitably be eliminated from the economic scene as the worker who cannot or will not adapt himself to them will be thrown into the streets without a job."

Max Weber (1905, p. 54)

Political economist, policy maker, and pioneer sociologist

Main publications

- 1905: The Protestant Ethic and the Spirit of Capitalism
- 1922: Economy and Society (magnum opus)

Personal life

Born in Germany to a devout Calvinist mother and an outgoing father who was a liberal politician and lawyer. His brother Alfred also became economist and sociologist and his wife, Marianne Schnitger, was a feminist activist and writer. Weber studied law, history, philosophy and political economy, and, like Marx, he drank and fenced a lot leading to fights with his parents.

Professional life

He worked in academia and politics. Already early in his career he was influential and controversial in public debates. He became increasingly depressed after his father died in 1897 just after a serious quarrel. After 7 years, he became professionally active again. He served in the German delegation to the Versailles peace negotiations and as advisor for the Weimar Constitution. He co-founded the centre-left liberal party Germany Democratic Party in 1918 and died two years later of pneumonia after contracting the Spanish flu.

Influences

Historical, Austrian and Marxian schools of economic thought as well as German idealism.

What makes capitalism unique?

The unique thing about capitalism is that profit is pursued through continuous 'rational' calculation of economic activities by bureaucratic enterprises.

To understand capitalism, Weber argued we should see it as a historical specific system that is unique to a certain time and place. This is in contrast to the idea that capitalism is universal and timeless, such as with a supposedly 'natural' predisposition for exchange and the 'homo economicus' which is assumed to always have existed everywhere.

Weber argued that ideas, culture and values of people matter in explaining capitalism in contrast to materialist economists, such as Marx, who emphasised the importance of property relations and production processes.

Origins of capitalism

Since capitalism is not a natural state of being but instead a way of organising economic life that is highly unique and different from most of history, its origins are relevant and helpful to understanding the system. Weber focused, in particular, on how it became possible to organise economic activities around calculable profits and law, and what values and motivations helped create the system. In other words, how the world came to be seen and treated as a range of calculable opportunities for profit.

The bureaucratic state and citizenship helped create calculable profit and law. Both the modern state and enterprise are bureaucratic rule-governed and calculable. Markets and bureaucracies are complementary and not opposed institutions. The modern European state based on rational-legal principles is administered by professional lawyers and removed feudal and patrimonial relations. This created a social and political space in which capitalist property relations and markets could develop. People became citizens with equal legal rights that provided a basis for formally equal contractual economic exchange and representative democracy.

The establishment of the state's monopoly over the means of coercion, through its courts, bailiffs, and police forces, was also central to capitalism's origins. States enforce not only their own commands, but also private property rights and the contracts private parties sign. Lawyers, judges, and other legal professionals thus shape how economies work and function as they are critical in determining what is allowed and how economic activities are supposed to function. Conflicts of interests surrounding property rights and contracts have to be dealt with and therefore are inherently political and distributional.

'Rationalising' the economy

Double-entry bookkeeping was a critical invention. But accounting also requires a society to have calculable economic production and distribution in the first place. The autonomy of business enterprises needs to be respected. Paid labour needs to be separated from domestic household activities. Considerations grounded in emotional ties, family obligations and traditional social norms that might interfere with strict economic rationality in the calculation and pursuit of profit need to be eradicated, or at least weakened to not dominate economic life.

The physical means of production came to be seen as the disposable property of private autonomous enterprises. This unique development permitted flexible switching of production to maximise profit by firing workers and selling physical capital for money which can be reinvested.

The commercialization of economic life means that all share rights in the enterprise and other forms of property and assets are represented by marketable paper instruments. This also created financial and speculative crises as the demand is stimulated by expectations of further rises in prices, which reverses when there is a loss of confidence and mass selling brings falling asset prices.

By superseding social relations based on kinship, tribe and status group, citizenship eroded ritualised communal exchange and the 'ethical dualism'. This meant that exchange within communities was normatively related by rules of fairness and an ethic of charity which minimised internal conflicts, while outsiders were cheated and exploited. For example, prohibition of usury was supposed to avoid exploitation within communities, and thus moneylending was generally done by societal outsiders (Jews in Christian Europe, Christians in the Islamic world, and Parsees in India). This ethical dualism prevented the formation of large markets based on impersonal trust.

Capitalist values

According to Weber, capitalist values come from western, Greek, Judaic, Christian and, in particular, Protestant culture. Peasants, workers as well as entrepreneurs generally used to stop working once they attained their normal level of income or resources. They simply tried to earn enough, not as much as possible, or as Weber said "man does not by nature wish to earn more and more money". These habits had to be erased and the pursuit of economic gain had to become the central goal and an end in itself rather than a means to other goals, for capitalism to be able to emerge. When capitalism has emerged, the market forces people to behave this way as businesses lose market competition and go bankrupt if they do not reinvest their profits to find ways to make even more profits.

In The Protestant Ethic and the Spirit of Capitalism, Weber noted an affinity between certain Protestant (especially Calvinist) beliefs and unremitting capitalistic profit-seeking. Unlike hedonism, Puritan's asceticism facilitated the reinvestment of profits for the expansion of enterprise. This was interpreted as the glorification of God on earth, it made making money a religious calling and worldly success became a possible sign of being chosen for salvation. Protestant theology also helped expunge superstition, magic and supernatural beliefs, which prevented instrumentally rational manipulation of nature by means of industrial technology. But once capitalism matured in the early 20th century Weber remarked "[t]he religious root of modern economic humanity is dead today" (Weber, 1927, 368). In this period, he sees religion as pacifying workers by promising happiness in the next world in compensation for the rigours of life under capitalism, like Marx did. And while capitalism arose out of religious devotion, it has become an inescapable "iron cage" in which rational calculation, bureaucracy and efficiency control human life.

The 'memorable alliance' between states and capitalists

In opposition to Marx, Weber argued capitalists did not simply control the state and that it is precisely the partial (in)dependence of states and capitalists that makes capitalism possible.

Marx argued that the state not only created the social relations of production but was constantly required to maintain the inequality of power on which they were based by controlling class conflicts and trying to resolve economic crises. Property was appropriated from some groups through coercive means and subsequently must be protected.

Weber instead thought that while capitalists depend on the state's power and they are not subordinated to it, they also do not dominate the state. The countervailing power of the independent economic bourgeois class was necessary to prevent state domination which is prevalent throughout history. The mutual accommodation of the state and bourgeoisie created the means to meet the fiscal needs for wars, with for example, the founding of the Bank of England in 1694. Fiscal systems based on 'public' banks and state borrowing, with interest payments on loans paid with taxes, were the means by which capitalist development was financed. This was not only domestic, as states competed in international markets for mobile capital produced and controlled by the independent cosmopolitan merchant class and their private banks.

The 'memorable alliance' is loose enough to allow capitalist classes to operate freely both within and between states as capitalism was from the beginning transnational. The state gave capitalism its opportunity for development and 'as long as the national state does not give place to a world empire capitalism will also endure' (Weber, 1927, 337). Capitalism flourishes as a global economic system in which neither the state nor capital subordinates the other. Capitalism would not collapse because of its contradictions as Marx argued, but rather endure through perpetual political conflict between states and an increasingly cosmopolitan bourgeoisie in which the balance of power swings around a bit but not too much. But full dominance by either side would undo the system:

- Subordination of capitalists to the interests of the state would destroy the dynamism of the system.
- Subordination of the state to the interests of capitalists would lead to excessive debilitating exploitation and political turmoil.

A world of power struggles

The market 'battle of man against man' with 'conflicts of interests in bargaining and competition ... to attain control over opportunities and advantages' was possible thanks to the absence of customary limitations on market exchange of products and factors of production (Weber, 1921, 38, 92-93).

In the absence of state or private monopolies, power struggles between economic interests happen through markets in accordance to the rules of the game enforced by the state. This enables the predictable formation of money prices which reflect relative scarcity. Changes in prices, relative or general (meaning inflation), thus reflect changing balances of power. Power struggles in markets:

- Market competition: Capitalists vs capitalists; workers vs workers
- Class conflict: Capitalists vs workers
- Market or monopoly power: Sellers vs consumers
- Financial interests: Lenders and creditors vs borrowers and debtors

Economic classes strive to monopolise any advantages in the market, rather than overthrow the system. Thus capitalism involves the tensions between the dynamism that market competition makes possible and the efforts of the participants to extend and preserve any advantage that they can secure.

Weber shared Marx his idea that power and exploitation were necessary for capitalism to work, but didn't agree it was doomed or should be abandoned. And if a political revolution would overthrow capitalism, Weber thought it would be more oppressive for workers as it would require a bureaucratic administration to manage a large complex industrial society, while the system would lose its dynamisms produced in capitalism by the general 'struggle for economic existence'.

Joseph Schumpeter (1883-1950): Creative destruction through credit-financed entrepreneurship

"'Credit operations' … affect the working of the capitalist engine – so much as to become an essential part of it without which the rest cannot be understood at all"

Joseph Schumpeter (1954, p. 318)

A horseman, lover and economist

Main publications

- 1934: The theory of economic development: An inquiry into profits, capital, credit, interest, and the business cycle
- 1942: Capitalism, Socialism and Democracy (breakthrough with large public)
- 1954: History of Economic Analysis

Personal life

Born in Austro-Hungarian empire to Catholic German-speaking parents with Czech roots, which he always denied. His father owned a factory but died when Schumpeter was only four years old. He studied law and married three times. His life goal was to be "the best horseman in Vienna, the best lover in Austria and the best economist in the world" and he told his students at Harvard University that he had achieved two, not saying which.

Professional life

He worked in academia, politics and finance. He was minister of finance in 1919 in Austria in a short-lived coalition between the social democrats and conservative Catholics. In 1932, he moved to the United States (Harvard) and helped central European colleagues to come as well and escape fascism. As a conservative, he was opposed to Marxism and Keynesianism as well as fascism.

Influences

Austrian, historical, Marxian, Weberian, Walrasian and classical schools of economic thought.

The capitalist entrepreneur

Schumpeter (1942, pp. 31-32) wrote that "Economic progress, in capitalist society, means turmoil." According to him, capitalist entrepreneurs do not simply play a passive role amounting to responding to price signals in the market. The entrepreneur constantly revolutionises the system with new goods, supply of raw materials, production methods, markets, and organisational structures to realise profit. Entrepreneurs don't simply compete, they change the nature of the competition.

Old industries and methods are swept away in a process of 'creative destruction'. The innovator reaps benefits from being at the frontier but this is only a temporary advantage as other businesses will adopt the same innovations and/or enter the new sector. Competition drives prices down and subsequent falling profits lead to a 'destructive' phase. Then the cycle can restart as entrepreneurs continue to search creatively for profitable innovations. Dynamic process is accelerated by a certain degree of monopolies which gives some protection during the costly and risky initial stages of innovation. Meaning monopolies are not necessarily inefficient.

Economic cycles

Schumpeter also theorised about how innovation relates to economic cycles with periods of new investment leading to increased production which lead to crises, recessions, and ultimately again recoveries. He also developed a typology of economic cycles according to their periodicity and characteristics:

- The Kitchin inventory cycle of 3 to 5 years
- The Juglar fixed-investment cycle of 7 to 11 years
- The Kuznets infrastructural investment cycle of 15 to 25 years
- The Kondratiev wave, or long technological cycle, of 45 to 60 years

Money markets as the 'headquarters of capitalism'

Schumpeter argued that capitalism comprised of two relatively autonomous interacting parts:

- The real material productive systems
- The monetary and financial systems

Money itself cannot create value, but in capitalism the wheels of the system are not set in motion without the prior creation of money for investment, production and consumption. The creation of money is an independent source of dynamism in capitalism.

According to Schumpeter, capitalism emerged from monetary innovations during the 16th and 17th centuries (rather than the industrialization of the 19th century as others argue). The money markets are the 'headquarters of capitalism' as access to money drives the 'capitalist engine'. The entrepreneur is a debtor by the nature of his economic function and its relationship to finance is central to capitalism. Entrepreneurs through loans with commercial banks get access to newly created money, which allows them to set up new business activities and generate economic growth. The economic process in capitalism starts with entrepreneurs getting in debt in order to hire workers and buy resources with which to produce and sell products so that the creditors can be paid back and profit can be made. The money markets and banks thus determine which capitalists and sectors will gain access to money and initiate new economic activities and thereby revolutionise the system, decidedly not being neutral to the real economy.

The nature of money

Schumpeter argued against prevalent ideas about money being nothing more than a neutral and passive medium to efficiently facilitate market exchange. Money was thought to simply be a 'veil' that influenced only nominal variables, like prices and exchange rates, but no real economic activities, like employment and real consumption (at least in the medium and long run). It was thought that economies were initially based on barter but at some point started using an intrinsically valuable material commodity, like gold or silver, as money, although historical evidence does not support this idea. Banks are thought of as merely being intermediaries between savers and borrowers, collecting savings to multiply and lend out for investment and that money is therefore neutral with regards to the real economy.

The view described above is often referred to as the commodity theory of money, while Schumpeter's ideas are generally associated with the credit theory of money. The credit theory of money states that all money regardless of form and substance, is a token claim or credit, promise to pay. Money should thus be understood as (tradable) credit, a token with which you can make a claim on real resources because of the social rules, not the intrinsic value of money. As such, money is a social relationship between creditor and debtor. The accumulation of money confers social power, as does the right to create money, which in capitalism is shared between the state and commercial banks.

According to Schumpeter, the early modern innovations of making debt tradable and allowing banks to create credit-money gave Western economies a dynamism that is unique in world history. When a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money. Money is produced simply by the debt contract between banks and borrowers, without needing to take it from existing savings or matching it by incoming deposits. Or in Schumpeter's words "the banker is not so much primarily a middleman in the commodity "purchasing power" as a producer of this commodity" (Schumpeter, 1934).

The coming death of capitalism

Schumpeter thought capitalism was going to die and wrote "Can capitalism survive? No. I do not think it can ... If a doctor predicts that his patient will die presently, this does not mean that he desires it" (1942). Despite his radically different politics from Marx, he reached the same conclusion that capitalism would be replaced by socialism. While Marx expected this to come about through a violent working-class revolution caused by worsening economic crises and exploitation, Schumpeter thought capitalism's success would paradoxically lead to a decline in support for the political-economic system.

Capitalist economic growth leads to an increasingly complex organisation of economic life. Small companies run by entrepreneurial merchants and their employees with strong personal bonds were replaced by large bureaucratic corporations with more loosely associated managers, workers and shareholders. Additionally the increase in prosperity leads to the growing size of the professional class with academics, journalists, teachers, and civil servants, that are further removed from commercial business activities. According to Schumpeter, these groups wrongly prefer more rational and stable economic bureaucratic systems over the dynamic creative destruction that entrepreneurial capitalism generates.

Additionally, he saw democracy as opposed to capitalism as many citizens demanded protection from the market and supported the creation of the welfare state. This line of thinking informed neoliberal ideas about protecting markets and thereby economic efficiency by placing economic activities outside of the reach of democratic decision making.

John Maynard Keynes (1883-1946): Saving capitalism from itself

"The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes."

John Maynard Keynes (1936, p. 372)

Cambridge don, patron of the arts, and pioneer macroeconomic theorist and policy maker

Main publications

- 1919: The Economic Consequences of the Peace (breakthrough with large public)
- 1936: The General Theory of Employment, Interest and Money (magnum opus)

Personal life

Born in Cambridge to the historian and politician Florence Ada Keynes and the economist John Neville Keynes, who both outlived Keynes. He studied mathematics and philosophy, but Alfred Marshall begged him to become an economist. While a workaholic himself, he strongly believed in leisure and shorter working-hours. In a period of world wars and economic depression, he saw the arts as crucial and ensured considerable private and public investment in it. He was part of the Bloomsbury Group consisting of writers, intellectuals and artists (like Virginia Woolf, E. M. Forster and Lytton Strachey) who did not conform to traditional Victorian morality, religiousness and sexuality. Keynes was a firm supporter of women's and gay's rights. Keynes's early romantic and sexual relationships were exclusively with men. Later he married Lydia Lopokova, a famous Russian ballerina. They were unable to have children.

Professional life

He worked as academic at Cambridge and as civil servant at the colonial India Office, UK Treasury, Versailles negotiations, Bank of England and Bretton Woods negotiations. While being a lifelong member of the Liberal party, he often refused political functions as he believed he could have more impact as a free public intellectual and policy advisor. He suffered a heart attack in 1937, preventing him from engaging in debates about his General Theory. He was central in shaping Allied economic policy during the Second World War as well as the post-war international economic and monetary arrangements. He is the exception to the rule that economists make horrible investors, as he successfully pioneered value investing, financial diversification and avoiding home country bias.

Influences

Classical, neoclassical, Stockholm and underconsumption schools of economic thought as well as credit and state theories of money.

Making capitalism work better

Keynes lived through arguably the most serious dangerous period that capitalist representative democracies have ever faced: The First World War, communist revolution, Wall Street Crash in 1929, the rise of fascism, the global economic depression and mounting unemployment in the 1930s and the Second World War. Whilst fascist and communist authoritarian regimes embarked on state-funded development which ensured full (though often forced) employment, Keynes aimed to solve the problem of depression and unemployment without sacrificing the economic and political liberalism of capitalist democracies. He observed that the "outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes" (Keynes, 1936, p. 372).

The conventional economic doctrine of the early 20th century (firmly entrenched in the British Treasury and the Bank of England) was that the 'invisible hand' of the market ensures full utilisation of all factors of production in the long run. Prices and wages just have to fall if there are unused factors, meaning that the solution to unemployment was often thought to be wage reductions. Keynes did not only argue that the process of reaching a market equilibrium might take too long, famously saying: "The long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is past the ocean is flat again".

But he also argued that even in fully flexible labour markets there might be unemployment because of a deficiency of effective demand. This meant the solution to unemployment was not reducing wages, which would actually make things worse by further reducing effective demand, or trying to perfect the market by removing rigidities that prevent prices and wages from changing quickly. Instead the government should play a central role in ensuring sufficient effective demand, thereby preventing depressions and unemployment while preserving economic and political liberties.

Keynes thus disagreed with the view that markets would return by themselves to their optimal level, stating that capitalism can remain chronically at less than optimum level of activity for long periods and that 'even approximately full employment is of rare and short-lived occurrence' (Keynes, 1936, 249-250). He, however, also did disagree with Marx's view that capitalism was doomed and would collapse through worsening crises as Keynes thought effective remedies and reform through government policy were possible.

Monetary economy of production

Money was often thought of as being neutral with regards to real economic activities. Money would simply allow people to more efficiently trade goods and services. This means that there is supposedly no reason for people to hold on to cash and it is thus assumed that all money is consumed or invested. Keynes, however, thought this was wrong as he saw money playing an active and central role in our economies, like Schumpeter did. Describing the modern economy without including money amounts to describing a barter economy rather than a monetary economy of production in which profit in the form of money is a central driver and goal of the system.

The pivotal paradoxical role of money in capitalist economies is that it can both be a driver of economic activities and dynamism as well as a cause for economic inactivity and slowdown. On the one hand, the creation of new money (through credit) can be used to expand production and employment. But on the other hand, money can also be used as a store of wealth, removing it from the economic system. While holding cash offers security for individuals, it diminishes economic circulation and activity at the macro level. People have a preference for liquidity, holding cash and temporary withholding it from circulation, because the future is uncertain. So although capitalist activity is based on calculation as Weber emphasised, uncertainty is an eradicable feature of human existence. Frank Knight (1921), an influential economist at the University of Chicago, therefore distinguished risk from uncertainty:

- Risk: Probabilities can be calculated (as in a casino)
- Uncertainty: Probabilities can not be calculated

Finance and the capital market

As the world is characterised both by risk and uncertainty, people are required to make decisions based on feelings of confidence, their 'animal spirits'. Keynes noted that stocks and shares are both a claim (in the form of dividends) on long-term realised profits of business enterprises as well as speculative assets whose current price can vary greatly based on changing feelings and expectations about the company's prospective profitability. The problem of uncertainty for shareholders, especially for estimating long-term yield given precariousness of knowledge available, is minimised by the liquidity of shares in the market, meaning that when things go worse than expected stocks can be readily convertible into cash.

However, this short term advantage for investors creates problems for real productive activities and at the aggregate level such flexibility can be disastrous causing massive drops in effective demand, mass sell-offs and bank runs. So when finance is allowed to be dominated by short-term speculation, real long-term investments in productive resources are undermined. And rather than aligning individual self-interest with collective welfare, markets can cause individual rationality to lead to collective irrationality.

The labour market and effective demand

During the early 20th century, it was common among the well-to-do to see wage cuts as the solution for unemployment and to think of unemployment being entirely the domain of individual responsibility and 'voluntary' as people would be able get a job if they would simply accept substantially lower wages. Keynes countered this line of reasoning by explaining that a reduction in wages only leads to more employment if capitalists expect greater profits from hiring more workers and increasing output. These expectations, however, are mainly about demand and lower wages actually reduce this.

Rather than solving unemployment and depression, cutting wages can lead to a downward deflationary spiral in which lower wages and prices lead to lower demand and production leading to further reductions in wages and prices continuing the cycle. Individual workers and capitalists cannot break this impasse of inadequate effective demand, but government stimulus in a time of crisis can provide the solution by ensuring sufficient purchasing power to maintain full employment. Or in his own words "The boom, not the slump, is the right time for austerity at the Treasury" (Keynes, 1937, p. 390).

The management of aggregate demand

As markets will not automatically generate the level of aggregate demand consistent with full employment, the government is required to step in. This caused Keynes to argue against the dominant doctrine in policy circles in the early 20th century of always balanced government budgets and 'sound finance' with an approach of countercyclical macroeconomic policy and 'functional finance':

- Sound finance: The central idea is that government budgets should always be balanced (expenditures equaling taxes) as government deficits were thought to necessarily lead to inflation because it is assumed that markets automatically generate full employment.
- Functional finance: When factors of production are not fully utilised, government deficits generate extra employment and economic output without causing inflation. Thus governments should analyse to what extent factors of production are utilised and adjust fiscal and monetary policy based on it.

Fiscal deficits can be financed by borrowing from the private sector or running up an overdraft at the central bank through monetary financing. And countercyclical policy is often not bad for long-term fiscal budgetary sustainability either as fiscal deficits in economic downturns will earn themselves back through the multiplier effect on employment and output, leading to higher tax revenues.

During the Second World War, his thinking gained widespread acceptance in government as he gave guidance in securing the non-inflationary full employment of the British economy's resources (How to Pay for the War, 1940). Internally, Britain would need to increase production while reducing consumption and diverting resources to the war effort. Externally, Britain would have to be able to count on more resources than internally available, thus running as large a trade deficit as its allies were willing to allow. Through large scale state allocation of resources, controlling prices, reducing luxury consumption, forced savings, and a deferred pay system with credits progressively repaid after the war, these goals were achieved.

In the last years of the war and right after it, Keynes played a central role during the Bretton Woods negotiations which led to the creation of an international monetary system and international organisations like the International Monetary Fund (IMF) and the World Bank. As the economic downturn in 1930s was made worse by competitive devaluations and 'beggar thy neighbour' policies aimed at exporting unemployment, a system of semi-fixed exchange rates was put in place. Furthermore, as speculation in financial markets and foreign exchange markets could hurt real economies, capital controls were introduced while there was free trade of real goods and services.

After the war, his ideas were reinforced by political commitments to maintaining full employment, strengthening the welfare state and stabilising global and national financial markets. The prevalent post-war idea was that the new social democratic settlement could be more easily financed when Keynes's recommendations were put to practice as full employment increased tax revenues and reduced demand for welfare support. The post-war period until the 1970s is often referred to as the Golden Age of Capitalism as it was characterised by high growth, low unemployment, low inflation and financial stability.

Conclusion

Here a short overview of the core insights per institution by thinker.

Markets: Market exchange of products and the factors of production

- Smith: Division of labour based on expanded markets creates wealth and harmony as prices convey information on scarcity.
- Marx: Workers are forced to sell their labour and work for capitalists to earn a living and survive.
- Keynes: Markets rarely lead to full employment due to a lack of effective demand.

Firms: Production by workers for enterprises owned by profit-seeking capitalists

- Weber: Continuous 'rational' calculation by bureaucratic enterprises to maximise profit.
- Schumpeter: Capitalist entrepreneurs don't simply compete, they change the nature of the competition through innovation.

Money: Money creation by commercial banks through credit

- Schumpeter: The money markets are the 'headquarters of capitalism' as access to credit-money drives the 'capitalist engine'.
- Keynes: Because the future is uncertain people's preference for liquidity can change rapidly and profoundly which can destabilise the economy.

State: Enforcement of private property rights and legal contracts

- Marx: Capitalism is founded on unequal property relations created and maintained by violence of the state.
- Weber: The 'memorable alliance' between states and capitalists is loose enough to allow capitalists to operate freely both within and between states.
- Keynes: The state can prevent depression and unemployment without sacrificing economic and political liberalism with counter-cyclical fiscal policies.

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