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The basic elements of capitalism

It is possible to discern a gradual shift of emphasis in our classic theorists' analyses of the capitalist economy. Each gives special – but not exclusive – attention to a particular element. Although Smith devoted considerable attention to the way in which capital 'stock' was used to employ labour, he focused on the rapid extension of the division of labour and market exchange in eighteenth-century 'commercial' society. By Marx's time in the mid-nineteenth century, the enterprise factory system was more firmly established, the struggles between capital and labour had intensified, and cycles of economic expansion and contraction had increased in severity and frequency. By the end of the century, more attention was given to the expanding banking system and the increasing role of capital markets. For example, Hilferding augmented Marx's analysis to take the emergence of 'finance capital' into account (see the discussion in Scott 1997: 22–5). But Schumpeter realized that money, banking and finance had been capitalism's most distinctive characteristics from the very earliest stages of development and that these were the key to understanding the system's operation. Obviously, Smith and Marx were not unaware of the monetary and financial side of capitalism, but they looked elsewhere for its definitive features. With Keynes, as we have seen, money takes on even more significance.

Taking these accounts as a whole we can identify three fundamental elements, or institutional clusters, of the capitalist economy:

A. monetary system for producing bank-credit money;
B. market exchange; and
C. private enterprise production of commodities.

A. Monetary system and bank-credit money

Market exchange and enterprise production cannot exist without a viable monetary system. First, the impersonal coordination of sellers and buyers – that is, supply and demand – by price signals in large-scale markets presupposes the existence of a means of exchange and payment. Second, as Weber emphasized, the calculation of costs of production and net profits in the enterprise requires a monetary standard of value (money of account). Third, money-capital for both production and financial speculation is created with loans (debt), produced by a network of banking enterprises which realize a profit from interest. Following Schumpeter, it could be argued that the financing of production with money-capital in the form newly created bank money uniquely specifies capitalism as a form of economic system. Enterprises, wage labour and market exchange existed to some small degree, at least, in many previous economic systems, but, as we shall see, their expansion into the dominant mode of production was made possible by the entirely novel institution of a money-producing banking system. Capital is 'that sum of means of payment which is available at any moment for transference to entrepreneurs' (Schumpeter (1961 [1911])).[1]

B. Market exchange

The exchange of commodities in markets is based on competition between buyers (demand) and sellers (supply), which produces a price at which exchange is acceptable. This mechanism of bids (demand) and offers (supply) coordinates the three phases in the capitalist production of commodities:

(i) finance (money-capital) → (ii) production (capital + labour) → (iii) consumption.

Bank credit finances investment (in the form of loans, stocks and shares) in physical capital and the employment of labour for the production of both the means of production and of consumption goods in order to realize a profit – that is, Marx's M-C-M_1. As we shall see, capitalism also contains purely speculative markets in financial assets which involve purely M-M_1 exchanges.

All forms of property, goods and services, including the enterprise and its potential revenue, are marketable as financial assets – stocks and shares, bonds, securities and so on. The uncertainty of financial asset price changes over time gives rise to speculative markets involving purely financial exchange in which assets are bought and sold in the expectation of price changes – that is, M-M_1 deals.[2] In this way, capital is endowed with a dual character – as both productive resource and speculative financial asset.

Thus capitalism contains the following basic markets:

a. the money and money-capital markets by which the supply and demand for finance is coordinated and its price (interest) established;
b. the labour market which determines wages;
c. two markets involved in production: (i) the market for production goods (means of production); and (ii) the final consumption goods; and
d. financial asset markets, based on the fact that the title to the ownership of all forms of property in capitalism is represented as a marketable 'asset'.

As the discussion of our theorists has shown, there are two quite divergent analyses of these interrelations. On the one hand, theories deriving from Smith's account of the 'invisible hand' emphasize the effectiveness of the market's decentralized coordination and integration of complex economic systems. In this model of capitalism, competition produces the most efficient outcome in which all resources are fully utilized.

Moreover, economic agents – bankers, workers, managers and so on – are rewarded in accord with their functional contribution, which is, in turn, determined by a competitive process of supply and demand. For example, a shortage in the supply of highly productive labour will lead to the substitution of labour-saving physical capital. Furthermore, this approach strongly implies that the economic integration and efficiency creates social integration by binding economic agents together in webs of mutually beneficial exchange.

On the other hand, Marx, Weber and – to some extent – Keynes point to the power inequalities of the property rights between economic classes and agents and to the fact that the divided economic functions do not simply cooperate, but struggle over the surplus. For example, capital, but not wage-labour, has the right to control the operation of the enterprise and to calculate and distribute profits. Furthermore, this tradition places emphasis on the unintended negative or contradictory effects of market coordination.

By enabling capital to be withdrawn from unprofitable activity and reinvested elsewhere, financial asset markets are an essential source of capitalism's flexibility and dynamism. But, as Keynes warned, this capacity can quickly incapacitate the economy if there is a widespread withdrawal of capital from production and/or consumption and its storage of capital in the form of money. Furthermore, pure speculation under conditions of uncertainty can routinely create asset price bubbles and instability that can perturb the production of goods and services.

Despite these different views on the efficacy and stability of the market mechanism, there is widespread agreement that market competition accelerates economic growth by driving capitalist entrepreneurs constantly to revolutionize the means of production in a process described by Schumpeter as 'creative destruction'.

C. Private enterprise production of commodities

The production of goods and services for sale on the market takes place in private enterprises which are institutionally separated from the household and state, where consumption takes place. Money-capital and wage labour are brought together in the enterprise, which aims to calculate the net cost of producing marketable commodities with an exchange value in order to realize a monetary profit. All means of production are the private property of the enterprise and constitute its physical or material capital. Production is undertaken by legally free labour, employed for wages by the enterprise.

The physical means and money used in the process of production are 'capital' in that they are not owned or controlled by those who directly operate the enterprise – workers and managers. In other words, as Marx explains, capital is not defined by its functional role in the process of production, but by a power relation. 'Money' becomes money 'capital' only with the existence of property-less labour – that is to say, a class of economic agents that can only subsist by selling their only 'property' – their labour power.

With the development of the large-scale corporation, comprising shareholders and salaried managers, it was widely held that private ownership had been separated from control of the enterprise to such an extent that capitalism was no longer an accurate designation of modern economies. However, as we shall see in chapter 6, both ownership and control of capital remain highly concentrated and outside the control of almost all employees.

Private ownership is not necessary for the physical means of production to be capital. States also own means of production, but if workers do not exercise control over their deployment, use and disposal, then it is more appropriate to refer to this as a form of 'state capitalism', rather than socialism. From this standpoint, for example, Saudi Arabia's oil and gas enterprise Saudi Aramco and Mexico's Pemex, as well as communist China's enterprises, are state capitalist.[3]

Again, the enterprise – like the market – can be looked at from two perspectives – as the functionally efficient means for the coordination of economic activity, or as the source of exploitation and site of the most intense conflict between economic agents and classes. These different conceptions of the enterprise will be examined in chapter 6, but here we should note that coordination within the enterprise is not based on the ‘invisible hand’. As Marx and Weber insisted, 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 ‘visible’ authority of the owners and controllers of capital.

These elements A, B, and C comprise a structurally differentiated ‘economy’ which is, in Polanyi’s terms, ‘disembedded’ from other non-economic institutions in society. Decisions about production and distribution of goods and services in the market capitalist economy are taken on the basis of an economic rationality – that is, costs of production and relative prices. In pre-market society the organization of production and distribution is ‘embedded’ in families, communities, manorial households or states. For example, the division of labour in simple hunter-gatherer societies was embedded in communal and familial relations. Men made tools and weapons and hunted; women made utensils, gathered vegetation and cooked. All labour was devoted to production for basic subsistence and use, not exchange; and distribution was governed by norms of in-group reciprocity. Traditional agrarian communities largely distributed production in accordance with an ethic or charity (Weber 1981 [1927]: 356). In empires – such as ancient Egypt – the surplus was collected and redistributed as rations by the central bureaucracy (Polanyi 1971 [1957]).

However, as we shall see, two crucially important related points must be borne in mind. First, the separation of the economy as a complex of distinct institutions does not mean that it is completely separate and autonomous from the other parts of society. Second, the market and other basic elements of the capitalist economy are not self-reproducing or self-regulating – that is to say, Smith’s ‘perfect liberty’ of freely contracted exchange relations did not emerge spontaneously. Rather, the ‘free’ market and all other institutions of the capitalist system – the enterprise, the banking system and so on – are all produced and maintained by state law, norms and cultural beliefs. As Marx emphasized in his critique of Smith, the revenues (rent, profits/interest and wages) received by the factors of production (land, capital and labour) were the result of the social relations of production – that is, property relations. Property gives capital the legal right to organize production in the enterprise. These issues will be examined further in part II; here we need simply to outline the main points for consideration.

The state

In simple terms and notwithstanding considerable variations between different countries and across time, relationships between the state and the structurally distinct market capitalist economy are the outcome of the mutual accommodation between the emerging capitalist bourgeoisie and the early modern state, described by Weber as the 'memorable alliance' (see pp. 32–4). The struggle between monarchs and merchants for control of opportunities for profit-making was resolved by a tacit agreement in which the bourgeoisie ceded their claim to rule in exchange for the right to make money in conditions secured and protected by the state. In return, the state was financed by taxation and loans from the propertied classes. In short, as we shall see in more detail in part II, capitalism is characterized by two interdependent sources of power – the state's legitimate use of force and the private ownership and control of economic resources (capital).

Modern capitalist states provide:

(i) a level of social order within which peaceful economic activity can take place;
(ii) an institutional and legal framework which specifies the rights of the various economic agents and the rules of competition and exchange – that is, the laws governing property rights and contracts between buyers and sellers;
(iii) a range of services and 'public goods' that would appear to be necessary for an effective capitalist economy, but which private enterprise is either reluctant or unable to undertake – for example, a sound currency, education and welfare to maintain the quality of the work force ('human capital'); and
(iv) attempts to correct the market's failure to achieve acceptable outcomes – for example, financial crises or

> persistent unemployment. In return, these activities are financed by taxation and loans with the consent of the economic interests of civil society.

Each of these 'functions' can be considered from the different perspectives on the operation of the capitalist system that we have encountered. Some would argue that the state's actions are based upon a disinterested search for the most effective and efficient means of running capitalism. Others contend that the regulation of the economy is the outcome of a conflict between irreconcilable interests that does not necessarily produce the most efficient outcome. In this regard, the Marxist perspective maintains that the state exists to ensure the dominance of capital and subordination of labour.

The scale and scope of the state's direct intervention and participation in the economy is continuously contested in a way that could almost be said to define the nature of politics in modern capitalist societies. On the one hand economic liberals, taking Smith as their guide, argue that the market has a capacity for self-regulation and, consequently, state involvement should be kept to a minimum. On the other hand, radical critiques, based in varying degrees on Marx, contend that market capitalism is crisis-prone and founded on economic inequality. State power should be used to curtail the depredations and destructive consequences of the capitalist class. Various 'middle' or 'third' ways have been sought, which seek to harness the productive efficiency of market capitalism to the attainment of politically determined goals and values – equality of opportunity, social justice, the eradication of poverty, health and even 'happiness' (for a critical survey of 'third way' discourse see Callinicos 2001).

The balance of power and interdependence between states and capital is characterized by a particular articulation of sovereign territorial space and market networks at the international level. Although capitalism is dependent on the social peace that states can bring about, it is by nature extraterritorial. In the most fundamental terms, what we now see as globalization may be understood as an acceleration of the process whereby capitalist networks and markets extend across the world. In this process, the complex relationship between the two 'logics' of political and economic power is revealed (see the discussion in chapters 8 and 9).

As we shall see, the idea that there exists a mutually reinforcing connection, or 'elective affinity', between the liberal democratic state and capitalism is well established in the social and historical sciences. Most obviously, as we have noted, Smith's 'perfect liberty' of the market has its foundation in the politically liberal state. Weber agreed and drew further connections between citizenship and capitalism. Furthermore, it is argued that modern representative democracy is an almost inevitable consequence of economic and political liberty. As I have already suggested, these issues are of the utmost contemporary importance as capitalism continues to spread across the world and in doing so encounters hitherto unreceptive regimes and forms of state in Islamic countries and communist China.

Culture and capitalism

Like all social systems, capitalism is 'cultural' in the sense that its economic activities are guided, framed and rendered meaningful to the participants by shared symbols, norms, beliefs and values.[4] Attention has been given to two main issues: the 'spirit' of entrepreneurial capitalism, and acquisitive consumerism. Capitalism is historically distinctive in that both production and consumption are freed from the limits set by traditional cultural constraints. Some level of luxurious 'conspicuous consumption' is to be found in all except the simplest subsistence-level societies, but only in modern capitalism does it become a major motive force in the economy. In short, if the culture of capitalism is unable to generate an ever increasing expansion and proliferation of consumers' wants, then the economy falters and enters a period of stagnation.

As Weber observed in late nineteenth-century Silesia, where traditionally limited patterns of consumption had not entirely disappeared, it was proving futile to increase the peasants' output by offering monetary incentives (Weber 1981 [1927]: 355). Raising the rates simply led the peasants to reduce their effort to the point that gave them the previous level to meet their customary level of consumption. Applying the same logic to enterprise production, Weber posed the question of why, in the absence of any economic compulsion, the early capitalist manufacturers persisted in their pursuit of profits far beyond the point at which their own consumption needs had been met. As is well known, he identified a distinctive 'spirit of capitalism' in which the pursuit of gain by the unceasing calculation of net profit had become an end in itself, rather than a means to affording a culturally prescribed style of life. But how did these entrepreneurs make sense of their historically atypical activity? Why, in early capitalism before competition in product markets, did they make profits only to plough them back into the enterprise? Protestantism's distinctive 'ethic', Weber famously concluded, had an 'elective affinity' with the 'capitalistic spirit'. The 'calling' to work and the glorification of God by the good stewardship of his gifts to humanity gave meaning to the relentless calculation and pursuit of profit for the improvement of enterprise, as opposed to mere avarice and greed.

In modern capitalism the compulsion to pursue profits now has a purely structural foundation; that is to say, it is driven by the quest for survival in competitive markets and by the demands of shareholders for dividends.[5] Nowhere is this more evident than in the absolute exigency that consumers' wants are stimulated without limit, lest falling demand triggers a recession and a downward spiral of factory closures, unemployment and ultimately social and political unrest. Marx's 'fetishism of commodities' is now institutionalized in the culture of modern capitalism, and personal identity in modern capitalism is largely achieved by the display of a distinctive pattern of 'lifestyle' of 'conspicuous consumption' (Slater 1997; Veblen 1994 [1899]).

However, it has recently been argued that purely materialist incentives fuelled by insatiable consumption demands can never provide sufficient basis for the continued willingness of individuals to participate in the capitalist system (Boltanski and Chiapello 2005). Unbridled hedonism, selfishness and greed can never provide an ethical legitimation for capitalism and, consequently, they will continue to attract critiques of the system. Paradoxically, this continually stimulates the formulation of new ideological justifications, that is to say, a 'new spirit of capitalism' which emphasises the 'collective benefits defined in terms of a common good' that it is claimed capitalism can produce (Boltanski and Chiapello 2005: 1–55). For example, discourse in management texts has appropriated values from the 1960s countercultural critique of capitalism and used them to characterize new non-hierarchical forms of work organization in which individuals can realize autonomy and self-expression.

With the exception of culture, these fundamental elements – the market mechanism in the capitalist economy, the monetary system and the production of bank-money, enterprise production and the struggle for its surplus, financial assets, and the state's roles in capitalism – will be examined separately and in more detail in the following chapters.